SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1966

No. 343

PRIMA PAINT CORPORATION, PETITIONER,

vs.

FLOOD & CONKLIN MFG. CO.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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IN THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

No. 30365

PRIMA PAINT CORPORATION, Plaintiff-Appellant,

against

FLOOD & CONKLIN MFG. CO., Defendant-Appellee.

MOTION TO DISMISS APPEAL—Filed March 15, 1966

Appellee, Flood & Conklin Mfg. Co., moves the Court to dismiss the appeal herein from the Order made by the Hon. Thomas F. Croake, District Judge for the United States District Court for the Southern District of New York and filed February 21, 1966, on the ground that said appeal is frivolous.

Appellee further moves this Court that it be awarded just damages for delay and its costs in accordance with 28 U.S.C. §1912.

Wachtel & Michaelson, By Martin A. Coleman, a Partner, Attorneys for Defendant-Appellee, 575 Madison Avenue, New York, New York 10022.

NOTICE OF MOTION TO DISMISS APPEAL—
Filed March 15, 1966

To:

Robert P. Herzog, Esq.
Attorney for Plaintiff-Appellant
280 Madison Avenue
New York, New York 10016

Notice is hereby given that on March 21, 1966, at 10:30 o'clock in the forenoon of that day, or as soon thereafter as counsel can be heard, the Defendant-Appellee in the

[fol. 2] above-entitled case will present to the United States Court of Appeals for the Second Circuit at the United States Courthouse, Foley Square, New York, New York, its motion to dismiss the appeal, and for such further relief as to the Court may seem fit and proper.

Annexed is a copy of said motion and of a Memorandum of Law in support thereof, which, together with this notice, are herewith served upon you.

Dated: New York, New York, March 14, 1966.

Wachtel & Michaelson, By Martin A. Coleman, A Partner, Attorneys for Defendant-Appellee, 575 Madison Avenue, New York, New York 10022.

[fol. 3]

[Title omitted]

AFFIDAVIT OF MARTIN A. COLEMAN IN SUPPORT OF MOTION TO DISMISS

State of New York,
County of New York, ss.:

Martin A. Coleman, being duly sworn, deposes and says:

1. I am a member of the firm of Wachtel & Michaelson, attorneys for Defendant-Appellee and am a member of the bar of this Court. This affidavit is respectfully submitted in support of Appellee's motion to dismiss the pending appeal as frivolous.

2. On March 3, 1966, Appellant filed a Notice of Appeal (Exhibit A annexed hereto) in which it states that it is appealing from the Order below (Exhibit B annexed hereto). Said Order, and the memorandum of Judge Croake upon which it is based (Exhibit C annexed hereto) denied plaintiff's motion to stay arbitration proceedings between the parties and granted defendant's motion to stay an action commenced by plaintiff seeking to rescind a contract between the parties on the ground of fraud in

the inducement. The Court below held that the arbitration clause contained in the agreement between the parties is sufficiently broad to cover a dispute over fraudulent inducement. It accordingly ordered the parties to proceed to arbitrate their disputes.

[fol. 4] 3. The motions of plaintiff and defendant had been argued before Judge Croake on November 23, 1965. From that date until the Order entered on February 21, 1966, defendant was precluded from proceeding with arbitration. After the Order was served, your deponent advised the American Arbitration Association of the outcome and was informed by their Tribunal Clerk that all necessary steps to expedite the arbitration proceeding would be commenced. Thereupon, however, Appellant filed its Notice of Appeal and obtained an *ex parte* stay from Judge Croake which temporarily restrains the parties from proceeding with arbitration during the pendency of the appeal.

4. There is annexed hereto the papers upon which the Court below rendered its decision that the action commenced by plaintiff should be stayed and that the disputes between the parties were to be resolved by arbitration. These papers are as follows:

I. Affidavit of Robert P. Herzog (plaintiff's attorney) sworn to November 12, 1965.

II. Affidavit of Martin A. Coleman (defendant's attorney) sworn to November 18, 1965, with the following exhibits annexed thereto:

1. Plaintiff's complaint.

2. The agreement between the parties which is an exhibit to the complaint.

3. Letter dated September 17, 1965, from plaintiff to my firm in which plaintiff raises various purported "breaches".

4. Defendant's Demand for Arbitration dated October 25, 1965.

[fol. 5] 5. Stipulation extending plaintiff's time to respond to said Demand until November 15, 1965.

6. Order of confirmation of plan of arrangement.

III. Affidavit of Robert Herzog sworn to November 22, 1965.

IV. Affidavit of Albert H. Shuger sworn to November 20, 1965.

5. It is obvious that plaintiff is seeking every possible means to delay the eventual arbitration of the dispute between the parties. Such delay, which is now of almost five months' duration, is highly detrimental to defendant since the moneys due to defendant from plaintiff, and upon which defendant relies, cannot be received until the matter is finally resolved. It is your deponent's further belief that there is absolutely no merit to the instant appeal and that it is merely another delaying tactic. This Court should accordingly dismiss the appeal as frivolous so that the parties may proceed to arbitrate their disputes. Further, because of the obvious delaying tactics by plaintiff, this Court should award defendant damages and double costs pursuant to 28 U.S.C. §1291. There is being submitted to this Court simultaneously herewith a Memorandum of Law in support of the contentions contained herein.

Wherefore your deponent prays for an Order dismissing [fol. 6] the instant appeal as frivolous and granting Defendant-Appellee damages and double costs.

Martin A. Coleman

Sworn to before me the 11th day of March, 1966.

Gloria J. Katzman, Notary Public, State of New York, No. (Illegible), Qualified in Kings County, Commission Expires March 30, 1967.

[fol. 7]

EXHIBIT A TO AFFIDAVIT OF MARTIN A. COLEMAN

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

65 Civil 3416

PRIMA PAINT CORPORATION,

Plaintiff-Appellant,

—against—

FLOOD & CONKLIN MFG. CO.,

Defendant-Respondent.

Filed
3-3-66

NOTICE OF APPEAL

SIRS:

PLEASE TAKE NOTICE, that the plaintiff-appellant in the above entitled matter, hereby appeals to the United States Court of Appeals for the Second Circuit, from the memorandum endorsement dated February 11, 1966, made by the Honorable Thomas F. Croake, U.S.D.J., and the order settled thereon dated February 21, 1966, on plaintiff-appellant's motion for a stay of arbitration and defendant-respondent's motion for a stay of proceedings pending arbitration, and each and every part thereof.

Dated: New York, N. Y.,
February 16, 1966

Yours, etc.,

ROBERT P. HERZOG
Attorney for Plaintiff-Appellant
280 Madison Avenue
New York, New York 10016

To:

Clerk of the United States District Court
Southern District of New York

Wachtel & Michaelson, Esqs.,
Attorneys for Defendant-Respondent
575 Madison Avenue
New York, New York 10022

[fol. 8]

Exhibit B to Affidavit of Martin A. Coleman

United States District Court

Southern District of New York

65 Civ 3416

Prima Paint Corporation,

Plaintiff,

—against—

Flood & Conklin Mfg. Co.,

Defendant.

Order

This cause having come on to be heard on the motion by plaintiff for an order, pursuant to Rule 65, Federal Rules of Civil Procedure, to stay arbitration, and on the motion by defendant, pursuant to Rule 7(b), Federal Rules of Civil Procedure and 9 U.S.C.A. §1 et seq., to stay this action pending arbitration, and the Court having heard the argument of counsel and being fully advised, it is

ORDERED that:

1. The motion by plaintiff to stay arbitration between the parties is denied.

2. The motion by defendant to stay this action until arbitration has been had in accordance with the terms of the Agreement between the parties dated October 7, 1964, is granted.

3. The parties are directed to proceed with arbitration in accordance with the terms of the Agreement between the parties dated October 7, 1964.

Dated: New York, New York
February 21st, 1966

/s/ THOMAS F. CROAKE
United States District Judge

U. S. District Court
Filed
Feb. 21, 1966
S. D. of N. Y.

[fol. 9]

EXHIBIT C TO AFFIDAVIT OF MARTIN A. COLEMAN

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

65—Civ. 3416

PRIMA PAINT CORPORATION,

Plaintiff,

—v.—

FLOOD & CONKLIN MFG. CO.,

Defendant.

CROAKE, District Judge

MEMORANDUM

These are motions: (a) by the plaintiff, pursuant to Rule 65, Fed. R. Civ. P., to stay arbitration, and (b) by the defendant, pursuant to Rule 7(b), Fed. R. Civ. P., and 9 U.S.C.A. § 1 et seq., to stay this action pending arbitration. Both motions will be decided in the instant opinion.

This action arises out of a Consulting Agreement entered into on October 7, 1964 whereby the defendant agreed to serve the plaintiff "in an advisory and consultative capacity," not to compete with Prima, and to turn over to the plaintiff certain customer lists. Prima agreed to make payments to Flood & Conklin, commencing September 1, 1965, based upon sales to former customers of the defendant. [fol. 10] Paragraph 8 of the Consulting Agreement states:

"8. *Arbitration.* Any controversy or claim arising out of or relating to this Agreement, or the breach thereof, shall be settled by arbitration in the City of New York, in accordance with the rules then obtaining of the American Arbitration Association, by three arbitra-

tors, one of whom shall be an attorney-at-law and one of whom shall be a certified public accountant, and judgment upon the award rendered may be entered in any Court having jurisdiction thereof. The costs of arbitration shall be shared equally by Prima and F&C."

On or about October 14, 1964, the defendant filed a voluntary petition under Chapter XI of the Bankruptcy Act. An Amended Plan of Arrangement was confirmed and the debtor was revested with its assets on March 16, 1965.

In a letter to the attorneys for the defendant dated September 17, 1965, the plaintiff alleged certain "breaches" of the agreement by F&C. On October 25, 1965 the defendant served a Notice of Intention to Arbitrate on the plaintiff; and, on November 12, 1965, three days before the expiration of the plaintiff's time to appear, answer or otherwise move with regard to the demand for arbitration, Prima instituted this action seeking to rescind the Consulting Agreement on the grounds of fraud in the inducement.

[fol. 11] In an affidavit dated November 20, 1965, one Albert A. Shuger, the President of the plaintiff, alleges that "the parties hereto had originally agreed to execute the agreement on October 21, 1964. However, upon the urging and pleas of Jerome K. Jellin, principal of the defendant corporation, because of the need of the proceeds of the sale for another business investment, the date was accelerated and the agreement executed earlier and on October 7, 1964 . . . . If the true facts had been known to the plaintiff, i.e., the defendant intended to file bankruptcy proceeding and immediately avail itself of the insolvency act, no agreement would have been entered into between the parties because such action would have and did damage, frustrate, impede and breach the agreement of the parties and was contrary to the very intention of the parties to the agreement . . . ." No fraud is specifically alleged with regard to the arbitration provision.

The court has read the extensive memoranda of law submitted and, after careful consideration, is of the opinion that this action should be stayed pending arbitration. [fol. 12] The plaintiff urges several lines of argument but they are of no avail. The arbitration clause herein is broad and is almost identical to the one recommended by the American Arbitration Association. See *In Re Kinoshita & Co.*, 287 F. 2d 951, 953 (2d Cir. 1961). In that case, it was stated in dictum that such a clause "would clearly have been sufficiently broad to cover a dispute over fraudulent inducement . . . ." 287 F. 2d at p. 953.

In the leading case of *Robert Lawrence Company* v. *Devonshire Fabrics, Inc.*, 271 F. 2d 402 (2d Cir. 1959), *cert. granted*, 362 U.S. 909 (1960), dismissed pursuant to Rule 60, 364 U. S. 801 (1960), the court held, in dealing with an arbitration clause similar to the one at bar, that: "We think that the charge of fraud in the inducement comes squarely within the phraseology of this particular agreement and that nothing short of a renascence of the old judicial hostility to arbitration could evolve a contrary ruling." 271 F. 2d at p. 412. See also p. 410 where Judge Medina, writing for the court, added that:

> "Finally, any doubts as to the construction of the Act ought to be resolved in line with its liberal policy of promoting arbitration both to accord with the original intention of the parties and to help ease the current congestion of court calendars. Such policy has [fol. 13] been consistently reiterated by the federal courts and we think it deserves to be heartily endorsed . . . . Once it is settled that arbitration agreements are 'valid, irrevocable, and enforceable' we know of no principle of law that stands as an obstacle to a determination by the parties to the effect that arbitration should not be denied or postponed upon the mere cry of fraud in the inducement, as this would permit the frustration of the very purposes sought to be achieved by the agreement to arbitrate, i.e., a

speedy and relatively inexpensive trial before commercial specialists."

Accordingly, the motion of the plaintiff to stay arbitration is denied and the motion of the defendant to stay this action pending arbitration is granted.

Settle order.

Dated: New York, N. Y.
February 10, 1966

/s/ THOMAS F. CROAKE
Thomas F. Croake
U. S. D. J.

U. S. District Court
Filed
Feb. 11, 1966
S. D. of N. Y.

[fol. 14]

ATTACHMENT I TO AFFIDAVIT OF MARTIN A. COLEMAN

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

PRIMA PAINT CORPORATION,

Plaintiff,

—against—

FLOOD & CONKLIN MFG. CO.,

Defendant.

STATE OF NEW YORK)
COUNTY OF NEW YORK) ss:

ROBERT P. HERZOG, being duly sworn, deposes and says:

That he is the attorney for the plaintiff herein, and as such, is fully familiar with all the facts and circumstances

herein, and makes this affidavit in support of plaintiff's application for a preliminary injunction and restraining order pursuant to Rule 65 of the Federal Rules of Procedure.

That contemporaneously with the application herein, plaintiff has instituted an action for rescision of contract by filing the summons and complaint with the Clerk of the United States District Court. A copy of the said complaint is annexed hereto and marked Exhibit A.

That annexed hereto and marked Exhibit B is a copy of a notice of intention to arbitrate pursuant to Section 7503 (c) of the New York State Civil Practice Law and Rules, which was served upon the plaintiff herein.

Annexed hereto as Exhibit C is a copy of a stipulation extending plaintiff's time to appear, answer or otherwise [fol. 15] move with regard to the said notice of intention to arbitrate heretofore served upon plaintiff by the attorneys representing the defendant.

That under the Civil Practice Law & Rules of the State of New York, the plaintiff is required to make a motion to a Court, to stay said arbitration, otherwise, the respondent would be precluded from asserting any defense as would constitute grounds for rescision of the contract.

The plaintiff will suffer immediate and irreparable injury unless the temporary restraining order is granted, prohibiting the defendant from proceeding with arbitration until the question of the validity of the contract, which is the subject matter of the District Court proceedings, can be litigated.

Deponent requests the Court to waive the giving of security by plaintiff herein for the reason that the defendant will not be pecunarily damaged if the temporary stay is granted inasmuch as it will only be prohibited from proceeding with a legal remedy which the plaintiff contends it is not entitled to because of the merits of the plaintiff's complaint. If the plaintiff prevails in the prosecution of its complaint herein, and the contract is rescinded, the defendant would not have been entitled to arbitration.

That no previous application for the relief herein sought has heretofore been made to this or any other Court.

WHEREFORE, deponent prays for the annexed order to show cause and temporary restraining order, restraining the defendant from proceeding with arbitration under an agreement dated October 7, 1964, until a hearing and [fol. 16] determination of the instant application, and for such other, further and different relief as to the Court may seem just.

.....

Sworn to before me this
12th day of November, 1965

[fol. 17]

ATTACHMENT II TO AFFIDAVIT OF MARTIN A. COLEMAN

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

Civil Action File No. 65 Civ. 3416

PRIMA PAINT CORPORATION,

Plaintiff,

—against—

FLOOD & CONKLIN MFG. CO.,

Defendant.

Affidavit in Support of Defendant's Cross-Motion to Stay Action Pending Arbitration and in Opposition to Plaintiff's Motion to Stay Arbitration

STATE OF NEW YORK)
COUNTY OF NEW YORK) ss.:

MARTIN A. COLEMAN, being duly sworn, deposes and says:

1. He is a member of the firm of Wachtel & Michaelson, attorneys for the defendant herein, and is fully familiar

with the facts and circumstances herein. This affidavit is submitted in support of defendant's cross-motion to stay this action, pursuant to Federal Arbitration Act, 9 U.S. C.A. §1 et seq., on the ground that the issue involved in this action is referable to arbitration under a written agreement, dated October 7, 1964, between the parties to this action. This affidavit is also submitted in opposition to plaintiff's motion herein, returnable pursuant to Order to Show Cause signed by the Honorable Justice Irving Ben Cooper, U.S. D.J. on November 15, 1965, on the 23rd day of November, 1965, requiring defendant to show cause why it should not be stayed, restrained and enjoined from proceeding with arbitration under said Agreement dated October 7, 1964.

2. Exhibit A to the Complaint in the above-captioned action is a Consulting Agreement dated October 7, 1964 between the parties to this action. Said Complaint, including [fol. 18] the Agreement, is annexed as Exhibit 1 hereto. By the terms of that Agreement, defendant (a) agreed to render advisory and consulting services (paragraph 2 of said Agreement), (b) agreed not to compete with plaintiff (paragraph 3 of said Agreement), and (c) turned over to plaintiff two lists of defendant's paint customers, consisting of an aggregate of more than 175 names of retail establishments in various states who were active customers purchasing paint for resale from defendant. These lists are referred to in paragraph 4(a) of the Agreement between the parties. In return, plaintiff agreed to make certain payments to defendant based upon sales to defendant's former customers on the lists. The first such payment was due September 1, 1965. (paragraph 4(c) of said Agreement).

3. Paragraph 8 of the aforesaid Consulting Agreement contains the agreement of the parties to arbitrate, as follows:

"8. *Arbitration.* Any controversy or claim arising out of or relating to this Agreement, or the breach thereof,

shall be settled by arbitration in the City of New York, in accordance with the rules then obtaining of the American Arbitration Association, by three arbitrators, one of whom shall be an attorney-at-law and one of whom shall be a certified public accountant, and judgment upon the award rendered may be entered in any Court having jurisdiction thereof. The costs of arbitration shall be shared equally by Prima [plaintiff] and F&C [defendant]."

4. As shown by the annexed letter, dated September 17, 1965 (Exhibit 2) from plaintiff to my firm as escrow agent, plaintiff has raised various purported "breaches" on the part of defendant relating to the Consulting Agreement. Pursuant to the agreement to arbitrate quoted above, defendant, on October 25, 1965, thereupon duly served upon plaintiff its Notice of Intention to Arbitrate (annexed hereto as Exhibit 3). Plaintiff's time to respond to said Notice was extended until November 15, 1965, by stipula- [fol. 19] tion (annexed as Exhibit 4 hereto). On November 12, 1965, a Friday, three days before its Answer to the Notice of Intention to Arbitrate was due to be served, plaintiff commenced this action in which, for the first time, it seeks to rescind—on the alleged grounds of fraud in the inducement—the Consulting Agreement. It also seeks by its motion to stay the pending arbitration despite the fact that no fraud relating to the rendition of consulting services, to the covenant not to compete, to the customer lists already turned over, or to the arbitration provision of the Agreement is even alleged by plaintiff. Indeed, since plaintiff has served no Memorandum of Law, its legal theory in support of its motion is not known.

5. Apparently, plaintiff is claiming that it was somehow fraudulently misled as to the solvency of defendant, because shortly after executing the Agreement, defendant filed a voluntary petition under the provisions of Chapter XI of the Bankruptcy Act. Plaintiff fails to point out, how-

ever, that defendant's Plan of Arrangement was accepted and that defendant was revested with its assets, as seen by the Order of Confirmation annexed hereto as Exhibit 5. Moreover, plaintiff has failed to point out how the foregoing could in any way have affected plaintiff to its detriment. At all events, it is crystal clear that there is no way in which the alleged fraud could have induced the arbitration provision agreed to by the parties.

6. In the Memorandum of Law submitted by defendant herewith, it is shown that the controlling decisions of the Court of Appeals for this Circuit require that, where an [fol. 20] arbitration provision as broad as that set forth in paragraph 3 of this affidavit is involved, a claim of fraud in the inducement must be submitted to arbitration, not to the court.

7. Moreover, under the applicable law discussed in the Memorandum of Law submitted herewith, mere allegations of fraud or false representation are not permitted to vitiate an agreement to arbitrate, since to hold otherwise would make it possible for any disgruntled contractor to avoid and delay his contractual obligations to arbitrate merely by glibly charging fraud or misrepresentation. Moreover, plaintiff has offered no affidavit of anyone present at either the negotiation or the execution of the Consulting Agreement with respect either to the claimed misrepresentation, or to the materiality of the claimed misrepresentation, or to the reliance by plaintiff thereon to its detriment.

8. In contrast, deponent, who participated in the negotiation and execution of the Consulting Agreement and who is thoroughly familiar with the correspondence between the parties subsequent and prior thereto, categorically asserts: (a) There was no misrepresentation; (b) defendant's financial condition at October 7, 1964 and the filing of its voluntary petition pursuant to Chapter XI of the Bankruptcy Act were not in any way material to the realization by plaintiff of the benefits contemplated by the Consulting Agreement; (c) plaintiff's reliance, as manifested

in the negotiations and in the Consulting Agreement, as well as in its conduct subsequent to October 14, 1964, was upon the customer lists of defendant which were delivered to plaintiff on October 7, 1964, on the agreement of defendant not to compete, and on the availability of Jerome [fol. 21] K. Jelin, an officer of defendant, to render consulting services, and no claim of fraud in respect to these matters is even alleged in the Complaint. Indeed, defendant was asked to, and did perform its consulting function without any claim of "fraud" having been raised by plaintiff until a year later; and (d) the arbitration provision in the Consulting Agreement was agreed to by both parties who where each represented by counsel. Indeed, counsel for plaintiff Prima commented on the arbitration clause during negotiations between the parties in August 1964, at which time counsel for both sides concurred in the desirability of having disputes resolved with the speed, and before the commercial specialists, available in arbitration proceedings.

By reason of the foregoing, it is respectfully urged the instant action should be stayed pending arbitration in accordance with the provisions of 9 U.S.C.A. §3 and costs of the motion should be allowed to defendant.

/s/ Martin A. Coleman
Martin A. Coleman

Sworn to before me this
18 day of November, 1965

Elsie Wilkes, Notary Public, State of New York, No. 30-4272700, Qualified in Queens County, Commission Expires March 30, 1967.

(Seal)

[fol. 22]

EXHIBIT 1 TO ATTACHMENT II

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

Plaintiff demands trial by jury.

PRIMA PAINT CORPORATION,

Plaintiff,

—against—

FLOOD & CONKLIN MFG., CO.,

Defendant.

Plaintiff, complaining of the defendant, by its attorney, ROBERT P. HERZOG, respectfully shows and alleges:

FIRST: Jurisdiction is founded on a diversity of citizenship and amount. Plaintiff is a corporation incorporated under the laws of the State of Maryland, having its place of business in the State of Maryland, and the defendant is a corporation incorporated under the laws of the State of New Jersey, having its principal place of business in a state other than the State of Maryland. The matter in controversy exceeds, exclusive of interest and costs, the sum of $10,000.00.

SECOND: That on October 7, 1964, plaintiff, Prima Paint Corporation (hereinafter referred to as "Prima"), and defendant, Flood & Conklin Mfg., Co. (hereinafter referred to as "F & C"), executed an agreement in writing, which was contemporaneously supplemented and adjusted, wherein and whereby, *inter alia*, Prima employed F & C and F & C [fol. 23] agreed to work for Prima for a six year period. A copy of the said agreement, without its contemporaneous supplements and adjustments, is hereto annexed as Exhibit A and made a part hereof, as if fully set forth at length.

THIRD: That by the terms of the aforesaid agreement, F & C promised to serve Prima in an advisory and consultative capacity to the extent that Prima may reasonably require, in connection with the formulae, manufacturing operations, sales and servicing of Prima's trade sales accounts.

FOURTH: That in consideration of the foregoing promise of F & C, Prima agreed to pay to F & C a percentage of all its receipts from customers of F & C or customers who purchased F & C's products, as defined in the said agreement, for the next six years, the total aggregate to F & C, however, not to exceed $225,000.00.

FIFTH: Among the provisions of the said agreement, it was provided that any controversy or claim arising therefrom would be settled by arbitration in the City of New York.

SIXTH: That upon the urging of F & C, its agents, servants, employees or attorneys, Prima was fraudulently induced to accelerate the execution and closing date of the said agreement herein, from October 21, 1964 to October 7, 1964.

SEVENTH: That prior to the execution of the aforesaid agreement, F & C, its agents, servants, employees, or attorneys, represented and stated to Prima that F & C was [fol. 24] in all respects a solvent corporation and able to perform all of the terms and conditions of the said agreement on its part to be performed.

EIGHTH: That the said representations and statements made by F & C, its servants, agents, employees or attorneys, that it was in all respects a solvent corporation and able to perform all the terms and conditions of the agreement on its part to be performed, were false and fraudulent when made and that F & C, its agents, servants, employees, or attorneys, knew or had reasonable cause to know that the representations and statements were false and fraudulent when made.

NINTH: That in truth and in fact, F & C was an insolvent corporation, and its agents, servants, employees or attorneys knew or had reasonable cause to know same, and upon information and belief, had consulted attorneys with regard to or had participated and prepared applications for a proceeding pursuant to the insolvency provisions of Chapter XI of the Bankruptcy Act.

TENTH: That on or about October 14, 1964, F & C filed a voluntary petition under the provisions of Chapter XI, Section 322 of the Bankruptcy Act in the United States District Court for the District of New Jersey.

ELEVENTH: That Prima, not knowing the truth with regard to the said statements and representations, but believing them to be true, and in reliance thereon, was thereby induced to accelerate the closing date thereof and execute the agreement referred to herein as Exhibit A.

[fol. 25] TWELFTH: That Prima relied on the aforesaid false and fraudulent representations and statements that F & C was in all respects a solvent corporation and able to perform all the terms and conditions of the agreement on its part to be performed, and Prima would not have accelerated the date of the execution, nor would Prima have entered into the said agreement hereinabove set forth, but for the false and fraudulent representations and statements made by F & C.

THIRTEENTH: That plaintiff has no adequate remedy at law.

WHEREFORE, plaintiff demands judgment that the agreement herein dated October 7, 1964, be rescinded, declared null and void, that Prima and F & C be made whole, and that the plaintiff have such other, further and different relief as to the Court may seem just and proper, together with the costs and disbursements of this action.

ROBERT P. HERZOG
Attorney for Plaintiff
Office & P. O. Address
280 Madison Avenue
New York, New York, 10016

PLEASE TAKE NOTICE, that pursuant to the provisions of the Rules of Civil Procedure, Prima Paint Corporation, plaintiff herein, demanded a trial by jury of the issues raised herein.

[fol. 26]

EXHIBIT 2 TO ATTACHMENT II

CONSULTING AGREEMENT

CONSULTING AGREEMENT dated October 7, 1964, between PRIMA PAINT CORPORATION, a Maryland corporation ("Prima"), and FLOOD & CONKLIN MFG. CO., a New Jersey corporation ("F&C").

Prima desires to secure the services of F&C on an advising and consulting basis, in connection with the take-over and operation of the Trade Sales business formerly conducted by F&C, and F&C is willing to perform such services.

NOW, THEREFORE, in consideration of the premises and of the mutual agreements hereinafter set forth, the parties hereto agree as follows:

1. *Employment and Term.* Prima hereby employs F&C and F&C agrees to work for Prima, on the terms and conditions hereinafter set forth, for a six year period (hereinafter called the "Consulting Period") commencing at the date hereof and ending at the close of business on October 7, 1970.

2. *Services.* During the Consulting Period, F&C shall serve Prima in an advisory and consultative capacity to the extent Prima may reasonably require, in connection with the formulae, manufacturing operations, sales and servicing of Prima Trade Sales accounts. It is agreed that such services shall be performed by Jerome K. Jelin, Chairman of F&C except in the event of his death or disability, and F&C

agrees to employ him for such purpose. Any out of pocket expenses incurred at Prima's request shall be reimbursed to F&C.

3. *Covenant Not to Compete.* F&C agrees that for a period of seventy-two (72) months from and after the date hereof it will not make any Trade Sales of paint or paint products (a) in the territory in which it was making such trade sales within the year prior to this date, or (b) to [fol. 27] any of the customers who purchased Trade Sales paint or paint products from F&C within the said one year period prior to this date.

4. In consideration of F&C's agreement not to compete in trade sales of paint and paint products and in consideration further of F&C's agreement to act as a consultant to Prima, Prima agrees to make payments to F&C in the amount and under the terms and conditions as follows (it being understood and agreed that wherever reference is made to "Prima" herein it shall include Prima as well as all of its subsidiaries and/or affiliates engaged in the paint business):

(a) Prima agrees to pay F&C an amount equal to Five (5%) percent of all of its receipts from customers of F&C listed in Exhibit "A" hereto, and Two (2%) percent of its receipts from those listed in Exhibit "B" hereto, in either case arising out of the sale of any and all paint and/or paint products by Prima to those so listed in Exhibits "A" and "B" during the term hereof, whether the paint and/or paint products so sold bears the labels, trade names heretofore used by F&C or any other labels, trade names or designation.

(b) Prima agrees during the term hereof to pay F&C an amount equal to Five (5%) percent of all of its receipts from its customers other than those covered by subdivision (a) who purchase F&C products (as hereinbelow defined), and except that where such customers are supermarkets other than those listed in Exhibit "B" hereto, Prima shall

only pay to F&C Two (2%) percent of its receipts from said supermarket customers. As used herein, F&C products shall mean any and all paint and/or paint products sold under the trade names, brand names, trade marks, formulae, patents and/or labels sold to Prima pursuant to Agreement with F&C dated August 21, 1964.

[fol. 28] (c) Starting the first day of the eleventh month after the closing date, namely, September 1, 1965, and on the first day of every month thereafter during the term hereof, Prima shall pay the sum of $2,500.00 per month to F&C as an advance against the percentage payments described in subparagraphs "(a)" and "(b)" of this Paragraph "4". If, however, the sales volume encompassed by subparagraphs "(a)" and "(b)" accounts shall fall below $600,000. in any full calendar year beginning with the year 1965, then Prima's obligation under this subparagraph "(c)" shall in the immediately succeeding year be reduced by $500. per month for each $100,000., or fraction thereof, of sales by which the aggregate sales falls below $600,000. If the sales in any later years increase and exceed $600,000. then the original amount to be paid monthly shall be resumed. By way of illustration: if such sales in the calendar years 1966, 1967 and 1968 should aggregate $450,000., $750,000. and $525,000., respectively, then the monthly advances to be paid in the years 1967, 1968 and 1969 shall be $1,500.00, $2,500.00, and $2,000.00 respectively.

(d) Beginning on the fifteenth day of February, 1965 and on the fifteenth day of every third month thereafter, Prima shall render to F&C a statement verified by Prima's chief financial officer, which statement shall (i) set forth the status of the account between the parties pursuant to "(a)" and "(b)" above, and (ii) itemize all sales made, and all payments received, by Prima, by customer name and amounts during the preceding three (3) months. The initial statement rendered hereunder shall cover the entire period from the closing date to the end of December, 1964.

(e) On March 1, 1965 and every March 1st thereafter, and then finally on the first day of the 74th month after the closing date, Prima shall render to F&C a statement certified by a certified public accountant setting forth the status of account between the parties covering the pre-
[fol. 29] ceding calendar year (the statement rendered on the 74th month shall cover only the period beginning with the last preceding January 1st until the end of the term hereof). At the time each statement required to be made under this subparagraph "(e)" is rendered, there shall be a cash settlement of the account between the parties.

(f) For the purposes of computing the amounts required to be paid under subparagraphs "(a)" and "(b)" hereunder, the amount of Prima's receipts shall be deemed to be the amount actually received plus any amounts by which the basic sales price has been reduced because of credits, allowances or waivers which relate directly or indirectly to allowances for advertising.

(g) The payments by Prima under "(a)" and "(b)" hereof shall cease when the aggregate amount paid to F&C equals $225,000. or upon the expiration of the term hereof, whichever is the first to occur.

(h) Notwithstanding the expiration of the term hereof, Prima shall continue to make payments to F&C based on the percentages set forth in subparagraphs "(a)" and "(b)" for all payments received by Prima after the expiration date arising out of sales encompassed by said subparagraphs which were shipped before the expiration date. On the tenth of the second month following the expiration date, and on the tenth of each month thereafter, Prima shall account and make payments to F&C under this subparagraph "(h)" covering all applicable receipts of the preceding months or month, as the case may be.

(i) Prima shall maintain for a period of seven (7) years from the date hereof all necessary books and records to sub-
[fol. 30] stantiate the sales and receipts reports provided

for herein. F&C shall have the right and authority to audit or otherwise verify Prima's sales and receipts and to that end shall have access to all relevant records of Prima.

5. *Notices.* Any notice to be given to F&C hereunder shall be sent by registered or certified mail addressed to it at 136 Chestnut Street, Newark 5, New Jersey, and c/o Wachtel & Michaelson, 575 Madison Avenue, New York, New York 10022, and any notice to be given to Prima hereunder shall be sent by registered or certified mail addressed to it at 819 South Caroline Street, Baltimore, Maryland, and c/o Charles M. Cahn, Jr., 912 Fidelity Building, Baltimore, Maryland.

6. *Miscellaneous.* (a) This Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns.

(b) This Agreement embodies the entire understanding of the parties on the subject matter and no amendment or modification of it shall be valid or binding upon the parties unless in writing.

7. Notwithstanding anything to the contrary contained herein, if at any time prior to the full completion of the payments due F&C from Prima, as set forth in paragraph "4" hereof, (i) there shall be filed against Prima in any court, pursuant to any Federal or state statute, a petition in bankruptcy or insolvency or for reorganization or for the appointment of a receiver or trustee of all or substantially all of Prima's property, and such petition shall not be stayed, dismissed or vacated within forty-five (45) days after the filing thereof, or (ii) Prima shall itself file as aforesaid a petition in bankruptcy or insolvency or for reorganization [fol. 31] under any Federal or state statute in aid of debtor or for the appointment of a receiver or trustee of all or a substantial part of its property, or (iii) Prima shall make an assignment for the benefit of creditors, or (iv) the estate or interest of Prima in the trade names and labels and/or the customer accounts and/or the good will represented

thereby, shall be levied upon or attached in any proceeding and such process is not vacated or discharged or adequately bonded by Prima within twenty (20) days after such levy or attachment, or (v) Prima fails to make any payments due to F&C as provided for in Paragraph "4" and within thirty (30) days after notice that such payments are delinquent, fails to make such payment or fails to adequately bond such amount or pay such amount in escrow to Messrs. Harry H. Wachtel and Charles M. Cahn, Jr., jointly, then and in any of such events there shall immediately become due to F&C from Prima the sum of $225,000., less any payments made pursuant to Paragraph "4", and in addition, all rights, estate or interest of Prima in and to the customer accounts set forth in Exhibits "A" and "B" annexed hereto, the trade names and labels and formulae comprising the F&C products shall automatically revert at once to F&C and shall once again become the absolute property of F&C without liability of any kind whosoever on F&C's part to return or repay any portion of the payments received by F&C from Prima hereunder. In any such event, no person, firm, corporation or other entity, except F&C shall have or obtain the aforesaid rights, estate or interest in and to said customer accounts, trade names and labels, and formulae or in and to the right to use said names or labels for the purpose set forth above.

8. *Arbitration.* Any controversy or claim arising out of or relating to this Agreement, or the breach thereof, shall be settled by arbitration in the City of New York, in accordance with the rules then obtaining of the American Arbitration Association, by three arbitrators, one of whom shall be an attorney-at-law and one of whom shall be a certified public accountant, and judgment upon the award rendered may be entered in any Court having jurisdiction thereof. The costs of arbitration shall be shared equally by Prima and F&C.

[fol. 32] 9. *Miscellaneous.* (a) Prima agrees that it will not sell, transfer or dispose of any of the customer accounts

set forth in Exhibits "A" and "B" annexed hereto, or the trade names and labels and formulae comprising the F&C products to any person, firm, or company unless such person, firm or company expressly undertakes to assume the obligation of Prima hereunder. In the event of any violation of this Agreement, then the provision of paragraph 7 shall apply.

(b) The individuals, partnerships or corporations listed in Exhibits "A" and "B", shall for all purposes hereof be deemed to include any successor entity thereto whether the same arises from merger, consolidation, combination or otherwise.

(c) This Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns.

(d) This Agreement embodies the entire understanding of the parties on the subject matter and no amendment or modification of it shall be valid or binding upon the parties unless in writing.

IN WITNESS WHEREOF, the parties hereto have caused this Purchase Agreement to be duly executed on the day and year first above written.

FLOOD & CONKLIN MFG. CO.

By: /s/ JEROME K. JELIN
Jerome K. Jelin, Chairman

ATTEST:

/s/ ARTHUR M. GOLDEN
Arthur M. Golden, President

PRIMA PAINT CORPORATION

By: /s/ ALBERT A. SHUGER
Albert A. Shuger

ATTEST:

/s/ CHARLES M. CAHN, JR.
Charles M. Cahn, Jr.

[fol. 33]

EXHIBIT 3 TO ATTACHMENT II

PRIMA PAINT CORPORATION
819 South Caroline Street
Baltimore, Maryland 21231

Executive Offices

September 17, 1965
Certified Mail

Wachtel & Michaelson
575 Madison Avenue
New York, New York

Gentlemen:

Enclosed is a check drawn on the account of Prima Paint Corporation in the amount of $2,500.00 payable to Harry H. Wachtel and Charles M. Cahn, Jr., jointly, escrow agents. Said check represents payment made as of September 1, 1965 under the provisions of Paragraph 4 (c) of Consulting Agreement dated October 7, 1964 between Prima Paint Corporation and Flood & Conklin Mfg. Co. The enclosed payment is made to said escrow agents because Flood & Conklin Mfg. Co. is presently indebted to Prima Paint Corporation for failure to comply with various provisions of the above described Consulting Agreement and for failure to comply with various provisions of Purchase Agreement dated August 21, 1964 between Flood & Conklin Mfg. Co. and Prima Paint Corporation, both as supplemented by Supplementary Agreement dated October 7, 1964 between Flood & Conklin Mfg. Co. and Prima Paint Corporation.

In due course the details of the violations of the above described agreements by Flood & Conklin Mfg. Co. will be specified and the amount of the claim of Prima Paint Corporation will be stated in a liquidated amount insofar as this can be done. Pending the furnishing of particulars

by Prima Paint Corporation the escrow agents are requested to continue to hold the proceeds of the above check in escrow.

Among the breaches of the above agreement by Flood & Conklin Mfg. Co. are the following:

(a) In order to induce Prima Paint Corporation to enter into the above agreements, Flood & Conklin Mfg. Co., it's agents, servants or employees represented to Prima Paint Corporation that Flood & Conklin Mfg. Co. was in all respects a solvent corporation and able to perform on the terms and conditions of the agreement, whereas, the truth and in fact Flood & Conklin Mfg. Co. was insolvent and intended to file Proceedings for Arrangement under the Bankruptcy Act shortly after making the agreement.

[fol. 34] (b) Flood & Conklin Mfg. Co. has failed to comply with the provisions of paragraph 4 of the Supplementary Agreement, in that it has failed to make the payments required of it whether to Prima or to the respective customers.

(c) Flood & Conklin Mfg. Co. has failed to consult with Prima Paint Corporation in accordance with the provisions and spirit of the above described Consulting Agreement, resulting in substantial losses to Prima.

(d) Flood & Conklin Mfg. Co. has interfered with Prima and with the customers of Prima who were acquired from Flood & Conklin Mfg. Co. by advising such customers that Prima was obligated to accept returns of merchandise sold by Flood & Conklin Mfg. Co. to such customers under circumstances where Prima had not agreed with Flood & Conklin Mfg. Co. to accept such returns.

(e) Certain Pebble Mills which were purchased by Prima from Flood & Conklin Mfg. Co. were permitted by Flood & Conklin Mfg. Co. to be taken by the Receiver into the possession of the Receiver and Prima incurred substantial expenses and counsel fees in recovering it's property, to wit the Pebble Mills, from the Receiver.

(f) Inventory bearing labels and names which had been sold exclusively by Flood & Conklin Mfg. Co. to Prima were sold at public auction by the Receiver in violation of Prima's exclusive ownership of such labels and names.

(g) Flood & Conklin Mfg. Co. failed to disclose to Prima certain exclusive Territorial Agreements in violation of the representations and warranties of Flood & Conklin Mfg. Co. contained in the Purchase Agreement.

(h) Efforts of the Receiver to collect accounts receivable of Flood & Conklin Mfg. Co. and the failure of Flood & Conklin Mfg. Co. to supply to Prima current information with respect to the status of the accounts receivable of Flood & Conklin Mfg. Co. made it impossible for Prima to collect such accounts receivable for Flood & Conklin Mfg. Co. in accordance with the provisions of the Purchase Agreement and seriously interfered with the relationship between Prima and the debtors thereby reducing the value of such debtors as potential customers of Prima.

[fol. 35] (i) Flood & Conklin Mfg. Co. promised to share the cost of dismantling the "Purchased Machinery and Equipment" and the loading of same on trucks, which contribution was later refused.

(j) Pursuant to the above agreements Prima Paint Corporation was to have the use of the premises of the Flood & Conklin Mfg. Co. up to January 15, 1965, which was denied by Flood & Conklin Mfg. Co.

Yours very truly,

PRIMA PAINT CORPORATION

/s/ [illegible]

Treasurer

AV/rs

cc: Mr. Jerome Jelin
Mr. Robert Solomon
Mr. Charles Cahn

[fol. 36]

EXHIBIT 4 TO ATTACHMENT II

DEMAND FOR ARBITRATION

October 25, 1965

Prima Paint Corporation
819 So. Caroline Street
Baltimore, Maryland

Prima Paint Corporation
c/o Charles M. Cahn, Jr.
912 Fidelity Building
Baltimore, Maryland

PLEASE TAKE NOTICE, under Section 7503, Subdivision (c) of the Civil Practice Law and Rules of the State of New York, that the undersigned, pursuant to the provisions of a contract dated October 7, 1964, which agreement provides as follows:

> "8. *Arbitration.* Any controversy or claim arising out of or relating to this Agreement, or the breach thereof, shall be settled by arbitration in the City of New York, in accordance with the rules then obtaining of the American Arbitration Association, by three arbitrators, one of whom shall be an attorney-at-law and one of whom shall be a certified public accountant, and judgment upon the award rendered may be entered in any Court having jurisdiction thereof. The costs of arbitration shall be shared equally by Prima & F&C."

hereby demands arbitration thereunder.

NATURE OF DISPUTE: Failure by Prima Paint Corporation to make payments to Flood & Conklin Mfg. Co. in the sum of $2,500 on the first day of each month, commencing September 1, 1965, pursu-

ant to the terms of a written contract between the parties dated October 7, 1964.

CLAIM OR RELIEF SOUGHT: An award that Prima Paint Corporation is liable to Flood & Conklin Mfg. Co. for payments of $2,500 per month commencing as of September 1, 1965, and continuing thereafter as set forth in the aforesaid contract between the parties dated October 7, 1964.

[fol. 37] PLEASE TAKE FURTHER NOTICE, that unless within ten days after service of this Notice of Intention to Arbitrate, you apply to stay the arbitration herein, you shall thereafter be precluded from objecting that a valid agreement was not made or has not been complied with and from asserting in court the bar of a limitation of time.

HEARING LOCALE REQUESTED: New York City (Pursuant to the terms of the Agreement).

You are hereby notified that copies of our Arbitration Agreement and of this Demand are being filed with the American Arbitration Association in its New York Regional Office, with the request that it commence the administration of the arbitration.

Yours, etc.

WACHTEL & MICHAELSON
Attorneys for Flood & Conklin Mfg. Co.
Office & P.O. Address
575 Madison Avenue
New York, NY 10022

[fol. 38]

EXHIBIT 5 TO ATTACHMENT II

In the Matter of the Arbitration of Certain Differences Between

FLOOD & CONKLIN MFG. CO.,

Petitioner,

—and—

PRIMA PAINT CORPORATION,

Respondent.

IT IS HEREBY STIPULATED AND AGREED, by and between Wachtel & Michaelson, attorneys for Flood & Conklin Mfg. Co., and Robert P. Herzog, attorney for Prima Paint Corporation, that the respondent's time to appear, answer or otherwise move with regard to the petitioner's demand for arbitration dated October 25, 1965, be and the same hereby is extended to and including November 15, 1965.

Dated: New York, N. Y.
November 2, 1965

/s/ WACHTEL & MICHAELSON
Attorneys for Petitioner

/s/ ROBERT P. HERZOG
Attorney for Respondent

[fol. 39]

EXHIBIT 6 TO ATTACHMENT II

UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF NEW JERSEY

In Proceedings for an Arrangement Under Chapter XI of the Bankruptcy Act

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In the Matter of:

FLOOD & CONKLIN MFG. CO., a New Jersey Corporation,

Debtor.

ORDER OF CONFIRMATION

This matter being opened to the Court by Ravin and Ravin, attorneys for the Debtor, and it appearing to the Court that a Petition has been filed by the above named Debtor proposing an arrangement under Chapter XI of the Act of Congress relating to Bankruptcy, and it appearing that the said Amended Plan of Arrangement has been duly accepted in accordance with the provisions of said Chapter and by said arrangement, and the sum of $70,225.14 having been deposited with the Receiver for the Debtor; and it further appearing that the provisions of said Chapter have been complied with, that the said Amended Plan of Arrangement is for the best interest of the creditors of the said Debtor and that the arrangement is feasible, that the Debtor has not been guilty of any of the acts or failed to perform any of the duties which would be a bar to the discharge of a bankrupt, that the proposal and acceptance are in good faith and have not been made or procured by any means, promises or acts forbidden by said Act, it is on this 16th day of March, 1965,

ORDERED, that the said Amended Plan of Arrangement be and it is hereby confirmed, and the Debtor is hereby revested with its assets, and it is further

[fol. 40] ORDERED, that the Amended Plan of Arrangement and its provisions shall be binding upon the Debtor, upon any person issuing securities or acquiring the property under the Amended Plan of Arrangement, and upon all creditors of the Debtor; whether or not they are affected by the Amended Plan of Arrangement or have accepted it or have filed their claims, and whether or not their claims have been scheduled or allowed and are allowable, and it is further

ORDERED, that this Court shall retain jurisdiction for the limited purpose of requiring the Debtor to post any additional deposits which may be required under its Plan of Arrangement with respect to any additional claims which may be filed within the statutory six month period and to make any orders relative thereto and for the enforcement thereof; and it is further

ORDERED, that the Debtor has leave of this Court, within 30 days from the last day to file claims herein, to move to reduce, expunge or challenge any claims scheduled by the Debtor or filed herein by the creditors of the Debtor.

(Signature Illegible)
Referee in Bankruptcy

A True Copy
(Signature Illegible)
Referee in Bankruptcy

[fol. 41]

ATTACHMENT III TO AFFIDAVIT OF MARTIN A. COLEMAN

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

No. 65 Civil 3416

PRIMA PAINT CORPORATION,

Plaintiff,

—against—

FLOOD & CONKLIN MFG. CO.,

Defendant.

STATE OF NEW YORK)
COUNTY OF NEW YORK) ss:

ROBERT P. HERZOG, being duly sworn, deposes and says:

That I am the attorney for the plaintiff, Prima Paint Corporation, and submit this affidavit, together with the annexed affidavit of Albert A. Shuger, president of Prima Paint Corporation, duly sworn to November 20, 1965, in support of plaintiff's application to stay arbitration pending a determination of the federal action for rescision heretofore instituted in this Court, and in opposition to the defendant, Flood & Conklin Mfg. Co.'s, cross-motion to stay the federal action pending arbitration.

The affidavit of Albert A. Shuger, unequivocally asserts the specific facts showing the fraudulent and false representation made to Prima and the effect and results arising therefrom.

It is clear from a reading of the agreement, Exhibit A annexed to the moving papers, that the parties intended [fol. 42] a viable corporation which would render the services agreed by the parties and insure smooth transition of the business, together with the goodwill that was inherent

therein. The default clause of the agreement (Par. 7th), revested certain property in F & C, *including the goodwill.* It is evident that the parties contemplated this goodwill and that it was a material part of the agreement.

The affidavit of Coleman alleges that there was "no fraud relating to the rendition of consulting agreement, to the covenant not to compete, to the customer lists," etc. (page 3). He appears to believe that the remedy of rescision of contract is separable to an agreement. Deponent submits that it is a hornbook principle of law that an instrument cannot be rescinded in part, *but must be rescinded in its entirety or not at all.* (*Friedman* v. *Richman,* 213 A.D. 467, 210 N.Y.S. 648; aff'd 241 N.Y. 576, 150 N.E. 561).

With regard to the materiality of the fraud, deponent believes it warrants little discussion because the materiality thereof is self-evident from a reading of the agreement.

Deponent submits, that the fact that the defendant successfully confirmed an arrangement in bankruptcy with its creditors does not expunge or vitiate the resultant losses, including the goodwill therefrom, the hiatus resulting therefrom and the deliberate misrepresentation that the defendant knew or had reasonable cause to believe that it would [fol. 43] not, and could not perform its part of the bargain set forth in the agreement. The defendant did not have any guarantees that it would be successful in effecting an arrangement with its creditors and could have quite easily been adjudicated and liquidated as a bankrupt.

The Coleman affidavit makes hay of the fact that the moving papers originally contained no affidavit of anyone present at either the negotiation or the execution of the agreement at issue herein.

It is obvious that this omission was merely temporary, and due to the fact that the plaintiff and its officers who have personal knowledge of the transactions, are non-resident of this State and the relief requested by the movant necessarily required short notice. The affidavit of Albert A. Shuger, president of the plaintiff, annexed hereto, more

than adequately cures this dilatory allegation which merely seeks to avoid the issues raised herein.

It is clear that an issue of fact is presented by the moving and answering papers which must be determined by the Court.

Deponent submits that the services and substance of this agreement, which was for a personal employment is not a contract evidencing a transaction in interstate commerce, regardless of the fact that the ultimate result of the production to which the advice and consultation related may or may not be commodities in interstate commerce; and regardless of the fact that interstate travel was an incident [fol. 44] to the advice and consultation bargained for, all of which is fully discussed in the memorandum of law submitted herewith.

It is therefore clear that these issues must be determined preliminarily by the Court herein.

Wherefore, deponent respectfully prays that the motion to stay arbitration be in all respects granted, and that the cross-motion be in all respects denied, and that the plaintiff have such other, further and different relief as may be just and proper in the premises.

/s/ Robert P. Herzog

Sworn to before me this
22nd day of November, 1965

[Stamp—Carolyn Andrews, Commissioner of Deeds, City of New York 1-74, Certificate Filed in New York County, Commission expires Sept. 24, 1966]

[fol. 45]

ATTACHMENT IV TO AFFIDAVIT OF MARTIN A. COLEMAN

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

No. 65 Civil 3416

PRIMA PAINT CORPORATION,

Plaintiff,

—against—

FLOOD & CONKLIN MFG., CO.,

Defendant.

STATE OF MARYLAND)
COUNTY OF BALTIMORE) SS.:

ALBERT A. SHUGER, being duly sworn, deposes and says:

That I am President of Prima Paint Corporation, the Plaintiff in the above action and was present during all of the negotiations, closing and execution of the agreement which is the subject matter of the litigation herein, and as such am fully familiar with all of the facts and circumstances thereof.

That the parties hereto had originally agreed to execute the agreement on October 21, 1964. However, upon the urging and pleas of Jerome K. Jellin, principal of the defendant corporation, because of the need of the proceeds of the sale for another business investment, the date was accellarated and the agreement executed earlier and on October 7, 1964.

The fact, which is alleged without contradiction in the pleadings and adopted by reference in the moving papers which initiated this motion, in uncontroverted by the cross-movant in his opposing affidavit.

Defendant's Exhibit 2 annexed to the opposition papers and cross-motion, clearly demonstrates the fact that the

claim of misrepresentation was raised and alleged in writing as early as September 17, 1965 and prior to any demon-
[fol. 46] strated intention on the part of the defendant to arbitrate and prior to the institution of any suit.

Deponent, who was present and participated in all negotiations and execution of the agreement in question unequivocably asserts that the defendant, Flood & Conklin Mfg. Co., represented to the plaintiff that it was in all respects a solvent corporation and able to perform the terms and conditions of the agreement on its part to be performed. If the true facts had been known to the plaintiff, i.e. the defendant intended to file bankruptcy proceeding and immediately avail itself of the insolvency act, no agreement would have been entered into between the parties because such action would have and did damage, frustrate, impede and breach the agreement of the parties and was contrary to the very intention of the parties to the agreement. The agreement contemplates a viable corporation with the good-will inherent therein, which would render the agreed employment service as set forth in the agreement.

During the time of the negotiations, and even upon the threshold of the execution of the agreement, the defendant knew or had reasonable cause to know that it was insolvent and, in fact, was preparing to immediately file a petition in bankruptcy, which it subsequently did a mere seven days later, all to the plaintiff's detriment and destruction of its own good-will and ability to fulfill its covenants.

As a result of the subsequent insolvency proceedings voluntarily initiated by the defendant, plaintiff was deprived of the advisory and consultative services that it reasonably required, in particular the manufacturing operations, sales and servicing of the customer accounts and the benefit of the defendant's good-will heretofore enjoyed with said customers.

[fol. 47] The agreement entered into between the parties on October 7, 1964, contemplated and intended an orderly transfer of the assets of the defendant to the plaintiff, and

further contemplated and intended that the defendant would consult, advise, assist and help the plaintiff so as to insure a smooth transition of manufacturing operations to Maryland from New Jersey, together with the sales and servicing of customer accounts and the retention of the said customers.

As a result of the voluntary filing of the bankruptcy proceedings, there was no orderly transfer as was agreed and intended by the parties, but rather chaos and havoc because of the interposition of a Receiver in Bankruptcy, a subsequent hiatus in the sales and servicing of the said accounts, resultant loss of good-will in connection therewith, and an inability on the part of the defendant to perform the terms and conditions of the agreement on its part to be performed, all of which was foreseeable by the defendant as a direct result of its misrepresentation.

That the applicable law with regard to the issues raised by the parties hereto is set forth in a memorandum of law which will be submitted upon the argument of this motion.

Wherefore, deponent respectfully prays that Flood & Conklin Mfg. Co., be stayed, restrained and enjoined from proceeding to arbitrate any claims or controversies arising out of the agreement dated October 7, 1964, between the parties to this action, until the validity of the said agreement has been determined by this Court, and that plaintiff have such other, further and different relief as may be just and proper.

/s/ ALBERT A. SHUGER
Albert A. Shuger

Sworn to before me this
20th day of November, 1965

/s/ A. ELY FEHESE
My commission expires 7/1/67

[fol. 48] [File endorsement omitted]

[fol. 49]

IN THE UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

PRIMA PAINT CORPORATION, Plaintiff-Appellant,

—against—

FLOOD & CONKLIN MFG. Co., Defendant-Appellee.

AFFIDAVIT OF ROBERT P. HERZOG IN OPPOSITION TO MOTION TO DISMISS—Filed March 18, 1966

State of New York,
County of New York, ss.:

Robert P. Herzog, being duly sworn, deposes and says:

That I am the attorney of record for the plaintiff-appellant herein, and as such, am fully familiar with all the facts and circumstances hereinafter set forth.

This affidavit is submitted in opposition to appellee's motion to dismiss the pending appeal as frivolous.

As set forth in the moving affidavit of Martin A. Coleman, paragraph 3 thereof, the motions of the plaintiff and defendant had been argued before Judge Croake on November 23, 1965, and subsequent thereto, both plaintiff and defendant were awaiting a decision thereon.

Thereafter, and on February 21, 1966, pursuant to the decision of Judge Croake, an order was entered, directing [fol. 50] the parties to proceed with arbitration. A copy of the said decision and order is annexed to the moving papers and marked Exhibits C and B respectively.

Appellant promptly thereafter filed its Notice of Appeal and obtained a stay from Judge Croake of his order dated February 21, 1966.

It is clear that appellant moved promptly upon the rendering of the decision and the entry of the order, and any delay in this matter was not of appellant's making.

In addition to the foregoing, it is not appellant's intention, nor have appellant's actions been such as to indicate an attempt to frustrate or impair the appellee's possible rights in this matter.

In matter of fact, appellant has been and is continuing to make payments under protest, to an escrow fund held jointly by Harry H. Wachtel and Charles M. Cahn, Jr., Mr. Wachtel being a member of the firm of Wachtel & Michaelson, attorneys for the defendant-appellee, (Exhibit 2, sub. (3) of the moving papers), thereby assuring the appellee that any delay would not materially affect their recovery, if any, in the proceeding.

As indicated in appellant's brief, submitted simultaneously herewith, there are several good and meritorious reasons for the appeal entered herein, and, as the various citations indicate, it has been the attitude of the Courts [fol. 51] that the right to a trial in a Court of law is a most serious and valuable right as against an informal proceeding in arbitration. Plaintiff-appellant seeks the protection of proceedings in courts of law with respect to a most serious question of fraud in the inducement, and, as clearly indicated in plaintiff-appellant's brief, there is much law to support plaintiff-appellant's rights herein.

In matter of fact, it is appellant's contention that the instant motion is an attempt by appellee to deprive appellant of its rights herein by forcing and pressuring the appellant to prepare and submit briefs on this question within a far shorter period than would have been permitted under the normal rules covering appeals in this Court.

The notice of motion herein was served on appellant on March 14, 1966 at 12:10 in the afternoon, plaintiff-appellant's briefs to be served and filed by 2:00 P. M. on March 18, 1966.

Accordingly, your affiant has, on behalf of plaintiff-appellant, prepared a short brief which merely highlights clearly and convincingly that there is a good and meritorious appeal herein, and that serious questions with respect to error on the part of the Court below exist.

It is clear that no question as to frivolity exists. This is not plaintiff-appellant's purpose as is evident from the

good faith in making the necessary payments under the escrow.

[fol. 52] Wherefore, your affiant prays that defendant-appellee's instant motion be dismissed and granting plaintiff-appellant costs and disbursements.

Robert P. Herzog

Sworn to before me this 17th day of March, 1966.

Carolyn Andrews

[Stamp—Carolyn Andrews, Commissioner of Deeds, City of New York 1-74, Certificate Filed in New York County, Commission expires Sept. 24, 1966]

[fol. 53] [File endorsement omitted]

[fol. 54]

IN THE UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Present: Hon. Sterry R. Waterman, Hon. Leonard P. Moore, Hon. Wilfred Feinberg, Circuit Judges.

PRIMA PAINT CORPORATION, Plaintiff-Appellant,

v.

FLOOD & CONKLIN MFG. Co., Defendant-Appellee.

ORDER DISMISSING APPEAL—May 12, 1966

A motion having been made herein by counsel for the appellee to dismiss the appeal for frivolousness and for other and further relief,

Upon consideration thereof, it is

Ordered that said motion be and it hereby is granted and that the appeal from the United States District Court for the Southern District of New York be and it hereby is dismissed with costs to the appellee.

[fol. 55] [File endorsement omitted]

[fol. 56]

IN THE UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

September Term, 1965.

(Submitted March 30, 1966 Decided May 12, 1966.)

Docket No. 30365

PRIMA PAINT CORPORATION, Plaintiff-Appellant,

—v.—

FLOOD & CONKLIN MFG. Co., Defendant-Appellee.

Before: Waterman, Moore and Feinberg, Circuit Judges.

OPINION—May 12, 1966

Appellee having served notice on appellant to proceed to arbitration, appellant commenced action in the United States District Court for the Southern District of New York to rescind the contract between the parties of which the agreement to arbitrate was one of several clauses. The parties then cross-moved, appellant to stay arbitration and appellee to have arbitration ordered. The court below, Croake, *J.*, granted appellee's motion and ordered the parties to proceed to arbitration, which order appellant sought to have reversed upon appeal. Appellee, claiming that the appeal was frivolous, moved to dismiss it. Motion to dismiss granted.

[fol. 57] Robert P. Herzog, New York City, for Plaintiff-Appellant.

Wachtel & Michaelson (David N. Brainin, Martin A. Coleman, of counsel), for Defendant-Appellee.

WATERMAN, Circuit Judge:

The district court ordered appellant and appellee to proceed with arbitration of their disputes and differences in

accord with an agreement they had entered into providing for settlement by arbitration of "Any controversy or claim arising out of or relating to this Agreement, or the breach thereof."

Appellant timely filed a notice of appeal and appellee has moved to dismiss the appeal as frivolous. After a full examination of the moving papers, briefs and affidavits of the parties, and the memorandum opinion below, we grant the appellee's motion and dismiss the appeal.[1]

We but sketchily summarize the situation out of which the arbitrable disputes arose lest by too detailed a statement we appear to be suggesting to the arbitrators the result they should reach.

On October 7, 1964, plaintiff-appellant, a Maryland corporation, and defendant-appellee, movant, a New Jersey corporation, entered into a contract which contained the following clause:

> 8. *Arbitration.* Any controversy or claim arising out of or relating to this Agreement, or the breach thereof, shall be settled by arbitration in the City of New York, in accordance with the rules then obtaining [fol. 58] of the American Arbitration Association, by three arbitrators, one of whom shall be an attorney-at-law and one of whom shall be a certified public accountant, and judgment upon the award rendered may be entered in any Court having jurisdiction thereof. The costs of arbitration shal be shared equally by Prima & F&C.

On September 17, 1965, plaintiff notified defendant that plaintiff claimed defendant had breached the contract (and listed among the claimed breaches ten specific ones), and therefore plaintiff was going to pay to an escrow agent monthly payments it had agreed to pay defendant under the contract. On October 25, 1965, defendant notified plain-

[1] See *Chatham Shipping Co.* v. *Fertex S.S. Corp.*, 352 F. 2d 291, 294-95 (2 Cir. 1965).

tiff that it was demanding arbitration of plaintiff's failure to pay to it these agreed monthly payments. This notification was made pursuant to Section 7503(c) of the New York Civil Practice Law and Rules, and defendant filed a copy of its demand with the American Arbitration Association, with a request that the Association commence the pre-arbitration details. On November 12, 1965, defendant having agreed to grant plaintiff an extension of time until November 15 within which to answer the arbitration demand, plaintiff commenced its action against defendant in the United States District Court for the Southern District of New York to obtain a rescission of the October 7, 1964 contract on the ground of alleged frauds by defendant at the time plaintiff was induced to enter into the contract. Plaintiff did not allege that it was fraudulently induced to enter into the arbitration clause.

Thereupon defendant moved pursuant to Rule 7(b), Fed. R. Civ. P. to stay plaintiff's action pending arbitration, and plaintiff cross-moved pursuant to Rule 65, Fed. R. Civ. P. to stay an arbitration pending adjudication upon the merits of plaintiff's action. Disposing of both motions simultane- [fol. 59] ously the district court denied plaintiff's motion, granted the stay defendant requested, and, as stated above, directed that an arbitration proceed.

Plaintiff's action is a diversity action, but if the contract sought to be rescinded evidences a transaction involving interstate commerce (excluding employment contracts of interstate workers) the arbitration clause in the contract is valid, irrevocable and enforceable unless grounds exist to revoke the contract, 9 U. S. C. §1, §2, and the court is required to order arbitration when "satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue. . . ." 9 U. S. C. §4.

Beyond peradventure the contract evidences a transaction involving interstate commerce. It provides, among other things, that for a period of six years New Jersey-based appellee would serve in an advisory and consultative capacity to Maryland-based appellant and would forthwith

turn over to appellant two lists of appellee's paint customers, which lists included some 175 establishments located in several states, which were active customers of appellee purchasing paint from appellee for resale. Among the matters concerning which appellee was to consult and advise appellant were, in appellant's words, "the manufacturing operations [and] sales and servicing of the customers accounts," and the agreement, according to appellant,

> ". . . contemplated and intended an orderly transfer of the assets of the defendant to the plaintiff, and further contemplated and intended that the defendant would consult, advise, assist and help the plaintiff so as to insure a smooth transition of manufacturing operations to Maryland from New Jersey, together with the sales and servicing of customer accounts and the retention of the said customers."

[fol. 60] Appellant's complaint below, seeking rescission of the contract, is based upon allegations that appellee fraudulently induced appellant to enter into this contract knowing that appellee was insolvent and could not satisfactorily perform the contractual commitments.

It is appellant's claim that allegations of "fraud in the inducement" contained in a complaint seeking contract rescission halts arbitration until the validity has been determined of the contract of which the arbitration clause is a part because a rescission action seeks to nullify the existence of that contract. In this circuit, ever since the leading case of *Robert Lawrence Company* v. *Devonshire Fabrics, Inc.*, 271 F. 2d 402 (2 Cir. 1959), *cert. granted*, 362 U. S. 909 (1960), *dismissed pursuant to Rule 60*, 364 U. S. 801 (1960) we have held that an arbitration agreement is separable from the contract within which it is contained. As it is separable, we have held that when there is no allegation of fraud in the inducement to enter into the agreement to arbitrate any controversies or claims arising out of, or re-

lating to, the agreement of which the arbitration agreement is a part, and which agreement is allegedly entered into by fraudulent inducement, the resolution of whether there was in fact fraud in the inducement is properly the province of the arbitrators and not of the court. *Robert Lawrence Company* v. *Devonshire Fabrics, Inc., supra* at 410; *El Hoss Engineer. & Transport Co.* v. *American Ind. Oil Co.*, 289 F. 2d 346, 349 (2 Cir. 1961); *Petition of Kinoshita & Co.*, 287 F. 2d 951 (2 Cir. 1961); *Amicizia Societa Navegazione* v. *Chilean Nitrate & Iodine Sales Corp.*, 274 F. 2d 805 (2 Cir.), *cert. denied*, 363 U. S. 843 (1960).

Here the arbitration provision incorporates the standard clause recommended by the American Arbitration Association, is broad and comprehensive, and, under the law of [fol. 61] this circuit, would most assuredly cover a dispute over fraudulent inducement. See *Petition of Kinoshita & Co., supra.*

Appellant would distinguish *Robert Lawrence* v. *Devonshire* on the ground that there the party seeking the stay of arbitration had sued for damages for a contract breach while here appellant seeks a rescission. We recognize the distinction, but point out that, though the recovery sought in the two cases may differ, the ground upon which each recovery is sought is that of the alleged fraudulent inducement, an issue we hold is one for the arbitrators to resolve. See also *Fabrex Corp.* v. *Winard Sales Co.*, Sup. Ct. New York County, 200 N. Y. S. 2d 278 (1960).

Appellant also maintains that, inasmuch as appellee served a notice to arbitrate pursuant to a provision of New York law prior to appellant's institution of suit in a federal court, appellee's federal court motion to compel arbitration filed in the federal court appellant chose, does not cause federal law to govern as to whether the issue of alleged fraud in the inducement should be adjudicated in court or resolved by arbitrators, but that New York law should control.

There is no merit in this contention. We quote *Robert Lawrence Co.* v. *Devonshire Fabrics, Inc., supra* at 409, and

". . . hold that the Arbitration Act in making agreements to arbitrate 'valid, irrevocable, and enforceable' created national substantive law clearly constitutional under the maritime and commerce powers of the Congress and that the rights thus created are to be adjudicated by the federal courts whenever such courts have subject matter jurisdiction, *including diversity cases,* just as the federal courts adjudicate controversies af- [fol. 62] fecting other substantive rights when subject matter jurisdiction over the litigation exists. We hold that the body of law thus created is substantive not procedural in character and that it encompasses questions of interpretation and construction as well as questions of validity, revocability and enforceability of arbitration agreements affecting interstate commerce or maritime affairs, since these two types of legal questions are inextricably intertwined." (Emphasis supplied.)

El Hoss Engineer. & Transport Co. v. *American Ind. Oil Co., supra; Petition of Kinoshita & Co., supra; Metro Industrial Painting Corp.* v. *Terminal Const. Co.,* 287 F. 2d 382 (2 Cir. 1961) at 384-385, and see separate concurring opinion of Judge Lumbard at 385 ff.; *Amicizia Societa Navegazione* v. *Chilean Nitrate & Iodine Sales Corp., supra.*

Appellee has moved for a grant to it of double costs, damages, counsel fees and expense reimbursement, all pursuant to 28 U. S. C. §1912, citing *Chatham Shipping Co.* v. *Fertex S.S. Corp.,* 352 F. 2d 291, 294-95 (2 Cir. 1965), and *A/S Krediit Pank* v. *Chase Manhattan Bank,* 303 F. 2d 648 (2 Cir. 1962). Appellee's motion is not wholly ill-founded, but we believe it better to deny it, for arbitration should now proceed promptly.

Appeal dismissed.

[fol. 63] Clerk's Certificate to foregoing transcript (omitted in printing).

[fol. 64]

SUPREME COURT OF THE UNITED STATES

No. 343—October Term, 1966

PRIMA PAINT CORPORATION, Petitioner,

v.

FLOOD & CONKLIN MFG. CO.

ORDER ALLOWING CERTIORARI—October 17, 1966

The petition herein for a writ of certiorari to the United States Court of Appeals for the Second Circuit is granted, and the case is placed on the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

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IN THE

Supreme Court of the United States

May Term, 1966

No. 343

PRIMA PAINT CORPORATION,

Petitioner,

v.

FLOOD & CONKLIN MFG. CO.,

Respondent,

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Of Counsel:

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IN THE

Supreme Court of the United States

May Term, 1966

PRIMA PAINT CORPORATION,

Petitioner,

against

FLOOD & CONKLIN MFG. CO.,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

TO THE HONORABLE CHIEF JUSTICE AND ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Petitioner prays that a writ of certiorari issue to review the judgment and order of the United States Court of Appeals for the Second Circuit (Waterman, Moore and Feinberg, Circuit Judges), entered herein on May 12, 1966 which dismissed petitioner's appeal from an order of the District Court of the United States for the Southern District of New York, granting respondent's motion to stay petitioner's action pending arbitration and denying petitioner's motion to stay respondent from arbitration, pending determination of an action instituted in said Court based upon the diversity of citizenship of the parties, seeking rescission of an agreement for fraud in the inducement thereof.

Citations to Opinions Below

The opinion of the United States District Court for the Southern District of New York (Croake, D. J.) is unreported and is printed *infra*, p. 1A. The opinion in the Court of Appeals is reported in 360 F. 2d 315, and printed *infra*, p. 7A.

Jurisdiction

The jurisdiction of this Court is invoked under 28 U. S. Code §1254(1). The judgment of the Court of Appeals was entered on May 12, 1966.

Questions Presented

1. Whether the Federal Arbitration Act enacted substantive federal law and, in consequence, requires the validity, enforceability and irrevocability of an arbitration clause, assuming *arguendo*, incorporated in a contract evidencing a transaction in interstate commerce, to be determined according to federal law, where such contract was in all other respects governed by state law, where federal jurisdiction existed solely by virtue of diversity of citizenship and where, *concededly*, state law respecting the validity, enforceability and irrevocability of the arbitration clause was contrary to the rule of federal law enunciated and applied by the court below.

2. Whether the federal substantive rule of law (if any there be), applicable to arbitration clauses contained in such contracts, is that a valid, enforceable and irrevocable arbitration clause exists as separable, special agreement between the parties, notwithstanding that it is contained in

a contract evidencing a transaction in interstate commerce, which had been induced by fraud unless it is shown that the fraud specifically relates to the inclusion of the arbitration clause in the fraudulently induced contract.

3. Whether as a matter of such federal substantive law (if any there be), an arbitration clause covering "any controversy or claim arising out of or relating to this agreement, or the breach thereof", requires arbitration of the question of whether the contract containing such arbitration clause has been fraudulently induced.

4. Whether a contract wherein and whereby one of the parties is employed to serve in an advisory and consultative capacity constitutes a contract evidencing a transaction involving interstate commerce.

Statutes Involved

The statutory provisions involved are §§2, 3 and 4 of the Federal Arbitration Act, 61 Stat. 669, 68 Stat. 1233, 9 U. S. C. §§2, 3 and 4, and §7503(c) of the New York Civil Practice Law and Rules. These provisions are reproduced in full, *infra*, p. 1B.

Statement of the Case

Petitioner, Prima Paint Corporation, a Maryland Corporation (hereinafter referred to as "Prima"), instituted an action in the United States District Court for the Southern District of New York on November 12, 1965 seeking to rescind a contract of employment dated October 7, 1964, containing an arbitration clause, alleging that the defend-

ant-respondent, Flood & Conklin Mfg. Co. (hereinafter referred to as "F & C"), a New Jersey corporation, had falsely and fraudulently induced Prima, the plaintiff, to accelerate the closing date thereof and execute same (Plaintiff's complaint and Ex. A, contract in dispute, *infra*, p. 1C). Immediately prior to the institution of this federal action, F & C, defendant, had served upon Prima a notice of intention to arbitrate, dated October 25, 1965, by certified mail, pursuant to §7503(c) of the Civil Practice Law and Rules of the State of New York (Printed *infra*, p. 2B). Under the decisions of the New York courts, the substantive effect thereof would have been to preclude Prima from objecting that a valid agreement was not made, unless Prima applied to a court to stay arbitration.

The jurisdiction of the court below was founded solely on diversity of citizenship and amount (Complaint, p. 1C). Petitioner alleged that respondent, knowingly, falsely and fraudulently represented that it was a solvent corporation, whereas seven days after execution of the said agreement, respondent F & C filed a voluntary petition under Chapter XI of the Bankruptcy Act and a Receiver of its property was appointed. Upon confirmation of its arrangement proceedings, respondent was revested with title to its property and the instant litigation ensued.

Contemporaneously with the institution of its suit, petitioner sought an order of the District Court pursuant to Rule 65, Federal Rules of Civil Procedure, to stay arbitration pending a disposition of its action instituted for rescission of contract. At the same time, the respondent moved pursuant to Rule 7(b) of the Federal Rules of Civil Procedure and 9 U. S. C. §1, *et seq.*, of the Federal Arbi-

tration Act to stay the federal action seeking rescission and obtain a direction of the Court to compel arbitration on the ground that the parties had, by virtue of an arbitration clause, agreed to arbitrate "any controversy or claim arising out of or relating to this agreement, or the breach thereof, ..."

Upon a finding that no fraud was specifically alleged with regard to the arbitration provision and that the said arbitration provision is sufficiently broad to cover a dispute of fraudulent inducement (p. 11A) the district court denied petitioner's motion to stay arbitration and granted the respondent's motion to compel arbitration, relying on the precedent established by *Robert Lawrence Company* v. *Devonshire Fabrics, Inc.*, 271 F. 2d 402 (2 Cir. 1959), *cert. granted*, 362 U. S. 909 (1960), *dismissed pursuant to Rule 60*, 364 U. S. 801 (1960).

An appeal was timely taken to the Court of Appeals, but prior to the time within which the record, briefs and appendices were to be filed, the defendant-appellee moved to dismiss the appeal as frivolous. Upon oral argument of the motion, the Court, at its own request and with consent of counsel, agreed to hear and determine the appeal on its merits, resulting in an opinion and order dismissing the appeal (p. 1a).

The Court of Appeals reaffirmed the precedent originally established by it in this Circuit in the case of *Robert Lawrence Company, supra,* holding that an arbitration agreement is separable from the contract within which it is contained, and that as such, where there is no allegation of fraud in the inducement to enter into the agreement to arbitrate, the resolution of whether there was in fact fraud

in the inducement is properly within the province of the arbitrators and not of the court. It further reaffirmed the unique principles established by it in the *Robert Lawrence* case that "the Arbitration Act in making agreements to arbitrate 'valid, irrevocable, and enforceable' *created national substantive law* clearly constitutional . . . and that the rights thus created are to be adjudicated by the federal courts whenever such courts have subject matter jurisdiction, *including diversity cases* . . ." (Emphasis supplied) (p. 12a).

Reasons for Granting the Writ

1. The Court of Appeals has reaffirmed an important question of federal law which has not been, but should be, settled by this Court.

This Court on March 7, 1960, granted a petition for a writ of certiorari in the case of *Robert Lawrence Company* v. *Devonshire Fabrics, Inc., supra.* The constitutional questions then presented were never resolved since the Writ of Certiorari was dismissed under Rule 60 as a result of the litigants settling their dispute. Reproduced, *infra* at pp. 1D-7D, are pages 5 through 12 of the petition of *Robert Lawrence Company* for Writ of Certiorari, wherein it eloquently sets forth the then compelling and cogent reasons why Certiorari should be and *was granted.* The fundamental reasons for granting the writ then are no less important now. The conflict of decisional law amongst the different circuits must be resolved and the constitutional questions relating to the proper application of substantive law, again raised herein, should be finally determined and laid to rest.

2. The Court of Appeals has wholly disregarded the constitutional caveat set forth in *Bernhardt* v. *Polygraphic Co. of America, Inc.*, 350 U. S. 198, 76 S. Ct. 273, 100 L. Ed. 199 (1956), by Mr. Justice Douglas in the opinion of the court, at p. 202:

> "We deal here with a right to recover that owes its existence to one of the States, not to the United States. The federal court enforces the state-created right by rules of procedure which it has acquired from the Federal Government and which therefore are not identical with those of the state courts. Yet, in spite of that difference in procedure, the federal court enforcing a state-created right in a diversity case is, as we said in *Guaranty Trust Co.* v. *York* (citation omitted), in substance 'only another court of the State.' The federal court therefore may not 'substantially affect the enforcement of the right as given by the State.' (citation omitted). If the federal court allows arbitration where the state court would disallow it, the outcome of litigation might depend on the courthouse where suit is brought. For the remedy by arbitration, whatever its merits or shortcomings, substantially affects the cause of action created by the State."

and again at p. 204:

> "There would in our judgment be a resultant discrimination if the parties suing on a Vermont cause of action in the federal court were remitted to arbitration, while those suing in the Vermont court could not be."

The Court of Appeals further ignored the constitutional question presented by Mr. Justice Frankfurter in his concurring opinion in *Bernhardt,* at p. 208, where he stated:

> "It would raise a serious question of constitutional law whether Congress could subject to arbitration litigation in the federal courts which is there solely because it is 'between Citizens of different States', U. S. Const., Art. III, §2, in disregard of the law of the State in which a federal court is sitting."

The substantive law of New York has not been altered. Fraud in the inducement of contract is a justiciable issue to be determined not by arbitration but by the court. The *Robert Lawrence* case acknowledged the substantive New York law when it noted, at p. 412:

> "We note that were we compelled to apply New York law to the principles involved in this case, we would have been forced to arrive at a contrary conclusion."

In June, 1960, the First Circuit Court of Appeals in *Lummus Company* v. *Commonwealth Oil Refining Co.,* 280 F. 2d 915 (1st Cir. 1960) *rehearing denied,* 280 F. 2d 932, *cert. denied,* 364 U. S. 911 (1960), which involved similar issues raised herein, i.e., separability of the arbitration clause and after examining at length the Second Circuit decision in the *Robert Lawrence* case, noted serous constitutional questions involved and observed at p. 924, n. 9:

> "In the Robert Lawrence case, the Second Circuit treated the separability issue as a matter of federal law under the U. S. Arbitration Act. We

question whether separability is a matter of federal rather than state law in a diversity case, whether or not the federal arbitration act applies for other purposes."

The court exhaustively examined into the substantive law of New York as to the issue of the separability of contract when it is alleged there was fraud in the inducement. It remarked at length, time and time again, on the distinction and difference in result, where a claim is made for damages for fraud in the inducement, as opposed to equitable rescission.

In the instant case, the court while noting that petitioner in its complaint seeks only equitable rescission of the contract (p. 11A) wholly disregarded the distinction and erroneously concluded that, inasmuch as the allegation is alleged fraudulent inducement, this issue was still arbitrable. It manifested complete indifference to the substantive rights created by virtue of petitioner's election of an equitable remedy.

The decision in the case at bar is in acknowledged conflict with the decision of the First Circuit in *Lummus, supra,* which decision followed the granting of certiorari in the *Robert Lawrence* case.

On rehearing, the court noted at p. 932 that it predicated its opinion on a finding "that Commonwealth was not really pursuing a restitutionary remedy . . . but that the true nature of the action was an endeavor to recover damages while rescinding the arbitration agreement alone . . . Although we recognize that New York may regard an arbitration clause as falling upon a rescission of the prin-

cipal agreement, we do not believe that it would carry this to the point of permitting . . . what in effect would be a true rescission of the arbitration clause only.'"

3. In the instant case, the defendant, F & C first elected to enforce and invoke to its *own benefit* the substantive effect of New York law by serving upon petitioner, Prima, a notice of intention to arbitrate under §7503(c) of the Civil Practice Law and Rules of the State of New York (p. 14C). Applying the substantive law of the State of New York, the petitioner would have been precluded and barred from objecting to the validity of the agreement unless the petitioner applied to a court to stay arbitration (p. 2B).

Petitioner could have chosen as a forum the state court offered by the defendant in its notice. Petitioner, however, pursuant to its constitutional privilege, sought its state-created substantive remedy in the federal district court based solely on diversity of citizenship between the litigants. Due to petitioner exercising its constitutional prerogatives, an anomalous result was achieved. The federal district court arrived at a result contrary to that which would have been obtained in the state courthouse next door. Accordingly, it is clear that there has been a serious deprivation of petitioner's constitutional rights which ought to be rectified by this court.

4. The only difference between the questions presented in the petition for a writ of certiorari in the *Robert Lawrence* case and the instant application, is that in the *Robert Lawrence* case the litigants conceded the fact that the contract, which was an interstate shipment of goods, con-

stituted a transaction in interstate commerce. In the instant case, the Court of Appeals held "Beyond peradventure the contract evidences a transaction involving interstate commerce" (p. 9A). It completely disregarded *Bernhardt* v. *Polygraphic Co. of America, Inc., supra, although* the case was cited at length in the briefs and argued extensively orally.

Since the question of jurisdiction under 9 U. S. C. A. is dependent upon whether the arbitration clause was a provision in a maritime transaction (not applicable here) or in a contract evidencing a transaction involving commerce, it becomes necessary to examine the pertinent facts to determine if the contract for the employment of F & C was a contract in interstate commerce.

The agreement herein employed F & C to work for Prima for a six year period (p. 5C; Paragraph 1). If the agreement had been carried into effect, Jerome K. Jelin, Chairman of F & C would have been required to perform the services of employment on behalf of F & C. Only his out-of-pocket expenses would have been reimbursed by Prima (p. 5C; Paragraph 2).

These facts do not make this contract one involving interstate commerce (*San Carlo Opera Co.* v. *Conley,* 72 F. S. 825, D. C. S. D. N. Y., 1946, *affirmed,* 163 Fed. 2d 310 (2d Cir. 1947). Any travel in connection with the agreement is a mere incident, not the essential thing. That to which it is incident—the advice and consultation—would not be called trade or commerce in the commonly accepted use of these words. Personal effort, not related to production, is not a subject of commerce. That which is in its consummation, not commerce, does not become commerce

among the states because transportation takes place (*Federal Baseball Club* v. *National League*, 259 U. S. 200; *Hart* v. *B. F. Keith Vaudville Exchange*, 12 Fed. 2d 341 (2d Cir.), *cert. denied*, 273 U. S. 704).

In the *Bernhardt* case, *supra*, the employee was a plant superintendent earning $15,000.00 a year with managerial duties fundamentally different than those of workers.

The Second Circuit, in a later opinion, *Metro Industrial Painting Corp.* v. *Terminal Construction Corp.*, 287 Fed. 2d 382, 387 (2d Cir. 1961), *cert. denied*, 368 U. S. 817, 82 S. Ct. 31 (1961), recognized that such an issue raises questions of fact when it observed,

> "The significant question, therefore, is not whether, in carrying out the terms of the contract, the parties *did* cross state lines, but whether, at the time they entered into it and accepted the arbitration clause, they *contemplated* substantial interstate activity. Cogent evidence regarding their state of mind at the time would be the terms of the contract and if it, on its face evidences interstate traffic, such as did the shipment from New York to Massachusetts in the Lawrence case, the contract would come within §2. In addition, evidence as to how the parties expected the contract to be performed and how it was performed is relevant to whether substantial interstate activity was contemplated."
>
> "the fact that it is necessary for one party to cross state lines in order to fulfill obligations arising out of the contract should not by itself bring the arbitration clause within the reach of the Federal Statute . . ." (*id.*, p. 388)

Squarely in point with the *San Carlo Opera* case, *supra*, the agreement involved herein was essentially personal employment and specified the particular person who would render said employment and therefore cannot be construed as commerce.

5. This court recognized the novel principle and far reaching effect resulting from *Robert Lawrence* when it took cognizance thereof and granted certiorari in 1960. There has been no change in the diverse opinions as between the various circuits, and this court has not passed upon the questions again presented herein since certiorari was granted in the *Robert Lawrence* case. The important questions of federal law, their far reaching effect and implications, their impact on commercial transactions, have not lessened in the interim. This court should grant this petition for the reasons set forth in the petition of *Robert Lawrence Company*, reproduced *infra* (p. 1D-7D), and for all of the additional reasons set forth above.

CONCLUSION

It is therefore respectfully submitted that this petition for a writ of certiorari be granted.

ROBERT P. HERZOG
Attorney for Petitioner Prima Paint Corporation
280 Madison Avenue
New York, N. Y. 10016
OR 9-8868

Of Counsel:

JULES TEITELBAUM

Appendix A—Opinions and Orders

Opinion of United States District Court for the Southern District of New York

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
65-Civ. 3416

[SAME TITLE]

CROAKE, District Judge

MEMORANDUM

These are motions: (a) by the plaintiff, pursuant to Rule 65, Fed. R. Civ. P., to stay arbitration, and (b) by the defendant, pursuant to Rule 7(b), Fed. R. Civ. P., and 9 U. S. C. A. §1 et seq., to stay this action pending arbitration. Both motions will be decided in the instant opinion.

This action arises out of a Consulting Agreement entered into on October 7, 1964 whereby the defendant agreed to serve the plaintiff "in an advisory and consultative capacity," not to compete with Prima, and to turn over to the plaintiff certain customer lists. Prima agreed to make payments to Flood & Conklin, commencing September 1, 1965, based upon sales to former customers of the defendant.

Paragraph 8 of the Consulting Agreement states:

> "8. *Arbitration.* Any controversy or claim arising out of or relating to this Agreement, or the breach thereof, shall be settled by arbitration in the

City of New York, in accordance with the rules then obtaining of the American Arbitration Association, by three arbitrators, one of whom shall be an attorney-at-law and one of whom shall be a certified public accountant, and judgment upon the award rendered may be entered in any Court having jurisdiction thereof. The costs of arbitration shall be shared equally by Prima and F&C."

On or about October 14, 1964, the defendant filed a voluntary petition under Chapter XI of the Bankruptcy Act. An Amended Plan of Arrangement was confirmed and the debtor was revested with its assets on March 16. 1965.

In a letter to the attorneys for the defendant dated September 17, 1965, the plaintiff alleged certain "breaches" of the agreement by F&C. On October 25, 1965 the defendant served a Notice of Intention to Arbitrate on the plaintiff; and, on November 12, 1965, three days before the expiration of the plaintiff's time to appear, answer or otherwise move with regard to the demand for arbitration, Prima instituted this action seeking to rescind the Consulting Agreement on the grounds of fraud in the inducement.

In an affidavit dated November 20, 1965, one Albert A. Shuger, the President of the plaintiff, alleges that "the parties hereto had originally agreed to execute the agreement on October 21, 1964. However, upon the urging and pleas of Jerome K. Jellin, principal of the defendant corporation, because of the need of the proceeds of the sale for another business investment, the date was accelerated and the agreement executed earlier and on October 7,

1964. . . . If the true facts had been known to the plaintiff, i. e., the defendant intended to file bankruptcy proceeding and immediately avail itself of the insolvency act, no agreement would have been entered into between the parties because such action would have and did damage, frustrate, impede and breach the agreement of the parties and was contrary to the very intention of the parties to the agreement. . . ." No fraud is specifically alleged with regard to the arbitration provision.

The court has read the extensive memoranda of law submitted and, after careful consideration, is of the opinion that this action should be stayed pending arbitration. The plaintiff urges several lines of argument but they are of no avail. The arbitration clause herein is broad and is almost identical to the one recommended by the American Arbitration Association. See *In Re Kinoshita & Co.*, 287 F. 2d 951, 953 (2d Cir. 1961). In that case, it was stated in dictum that such a clause "would clearly have been sufficiently broad to cover a dispute over fraudulent inducement. . . ." 287 F. 2d at p. 953.

In the leading case of *Robert Lawrence Company* v. *Devonshire Fabrics, Inc.*, 271 F. 2d 402 (2d Cir. 1959), *cert. granted*, 362 U. S. 909 (1960), dismissed pursuant to Rule 60, 364 U. S. 801 (1960), the court held, in dealing with an arbitration clause similar to the one at bar, that: "We think that the charge of fraud in the inducement comes squarely within the phraseology of this particular agreement and that nothing short of a renascence of the old judicial hostility to arbitration could evolve a contrary ruling." 271 F. 2d at p. 412. See also p. 410 where Judge Medina, writing for the court, added that:

"Finally, any doubts as to the construction of the Act ought to be resolved in line with its liberal policy of promoting arbitration both to accord with the original intention of the parties and to help ease the current congestion of court calendars. Such "policy has been consistently reiterated by the federal courts and we think it deserves to be heartily endorsed. . . . Once it is settled that arbitration agreements are 'valid, irrevocable, and enforceable' we know of no principle of law that stands as an obstacle to a determination by the parties to the effect that arbitration should not be denied or postponed upon the mere cry of fraud in the inducement, as this would permit the frustration of the very purposes sought to be achieved by the agreement to arbitrate, i. e., a speedy and relatively inexpensive trial before commercial specialists."

Accordingly, the motion of the plaintiff to stay arbitration is denied and the motion of the defendant to stay this action pending arbitration is granted.

Settle order.

Dated: New York, N. Y.
February 10, 1966

/s/ THOMAS F. CROAKE
THOMAS F. CROAKE
U. S. D. J.

(Seal)

Appendix A—Opinions and Orders

Order of United States District Court for the Southern District of New York

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

[SAME TITLE]

65 Civ. 3416

ORDER

This cause having come on to be heard on the motion by plaintiff for an order, pursuant to Rule 65, Federal Rules of Civil Procedure, to stay arbitration, and on the motion by defendant, pursuant to Rule 7(b), Federal Rules of Civil Procedure and 9 U. S. C. A. §1 et seq., to stay this action pending arbitration, and the Court having heard the argument of counsel and being fully advised, it is

ORDERED that:

1. The motion by plaintiff to stay arbitration between the parties is denied.

2. The motion by defendant to stay this action until arbitration has been had in accordance with the terms of the Agreement between the parties dated October 7, 1964, is granted.

3. The parties are directed to proceed with arbitration in accordance with the terms of the Agreement between the parties dated October 7, 1964.

Dated: New York, New York
February 21st, 1966

/s/ THOMAS F. CROAKE
United States District Judge

U. S. District Court
Filed
Feb. 21, 1966
S. D. of N. Y.

Appendix A—Opinions and Orders

Opinion of United States Court of Appeals for the Second Circuit, Dismissing Appeal

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

September Term, 1965.

(Submitted March 30, 1966 Decided May 12, 1966.)

Docket No. 30365

[SAME TITLE]

Before:

WATERMAN, MOORE and FEINBERG,

Circuit Judges.

WATERMAN, *Circuit Judge*:

The district court ordered appellant and appellee to proceed with arbitration of their disputes and differences in accord with an agreement they had entered into providing for settlement by arbitration of "Any controversy or claim arising out of or relating to this Agreement, or the breach thereof."

Appellant timely filed a notice of appeal and appellee has moved to dismiss the appeal as frivolous. After a full examination of the moving papers, briefs and affidavits of the parties, and the memorandum opinion below, we grant the appellee's motion and dismiss the appeal.[1]

We but sketchily summarize the situation out of which the arbitrable disputes arose lest by too detailed a state-

[1] See *Chatham Shipping Co.* v. *Fertex S.S. Corp.*, 352 F. 2d 291, 294-95 (2 Cir. 1965).

ment we appear to be suggesting to the arbitrators the result they should reach.

On October 7, 1964, plaintiff-appellant, a Maryland corporation, and defendant-appellee, movant, a New Jersey corporation, entered into a contract which contained the following clause:

> 8. *Arbitration.* Any controversy or claim arising out of or relating to this Agreement, or the breach thereof, shall be settled by arbitration in the City of New York, in accordance with the rules then obtaining of the American Arbitration Association, by three arbitrators, one of whom shall be an attorney-at-law and one of whom shall be a certified public accountant, and judgment upon the award rendered may be entered in any Court having jurisdiction thereof. The costs of arbitration shall be shared equally by Prima & F&C.

On September 17, 1965, plaintiff notified defendant that plaintiff claimed defendant had breached the contract (and listed among the claimed breaches ten specific ones), and therefore plaintiff was going to pay to an escrow agent monthly payments it had agreed to pay defendant under the contract. On October 25, 1965, defendant notified plaintiff that it was demanding arbitration of plaintiff's failure to pay to it these agreed monthly payments. This notification was made pursuant to Section 7503(c) of the New York Civil Practice Law and Rules, and defendant filed a copy of its demand with the American Arbitration Association, with a request that the Association commence the pre-arbitration details. On November 12, 1965, defendant having agreed to grant plaintiff an extension of time until

November 15 within which to answer the arbitration demand, plaintiff commenced its action against defendant in the United States District Court for the Southern District of New York to obtain a rescission of the October 7, 1964 contract on the ground of alleged frauds by defendant at the time plaintiff was induced to enter into the contract. Plaintiff did not allege that it was fraudulently induced to enter into the arbitration clause.

Thereupon defendant moved pursuant to Rule 7(b), Fed. R. Civ. P. to stay plaintiff's action pending arbitration, and plaintiff cross-moved pursuant to Rule 65, Fed. R. Civ. P. to stay an arbitration pending adjudication upon the merits of plaintiff's action. Disposing of both motions simultaneously the district court denied plaintiff's motion, granted the stay defendant requested, and, as stated above, directed that an arbitration proceed.

Plaintiff's action is a diversity action, but if the contract sought to be rescinded evidences a transaction involving interstate commerce (excluding employment contracts of interstate workers) the arbitration clause in the contract is valid, irrevocable and enforceable unless grounds exist to revoke the contract, 9 U. S. C. §1, §2, and the court is required to order arbitration when "satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue. . . ." 9 U. S. C. §4.

Beyond peradventure the contract evidences a transaction involving interstate commerce. It provides, among other things, that for a period of six years, New Jersey-based appellee would serve in an advisory and consultative capacity to Maryland-based appellant and would forthwith turn over to appellant two lists of appellee's paint customers, which lists included some 175 establishments lo-

cated in several states, which were active customers of appellee purchasing paint from appellee for resale. Among the matters concerning which appellee was to consult and advise appellant were, in appellant's words, "the manufacturing operations [and] sales and servicing of the customers accounts," and the agreement, according to appellant,

> "... contemplated and intended an orderly transfer of the assets of the defendant to the plaintiff, and further contemplated and intended that the defendant would consult, advise, assist and help the plaintiff so as to insure a smooth transition of manufacturing operations to Maryland from New Jersey, together with the sales and servicing of customer accounts and the retention of the said customers."

Appellant's complaint below, seeking rescission of the contract, is based upon allegations that appellee fraudulently induced appellant to enter into this contract knowing that appellee was insolvent and could not satisfactorily perform the contractual commitments.

It is appellant's claim that allegations of "fraud in the inducement" contained in a complaint seeking contract rescission halts arbitration until the validity has been determined of the contract of which the arbitration clause is a part because a rescission action seeks to nullify the existence of that contract. In this circuit, ever since the leading case of *Robert Lawrence Company* v. *Devonshire Fabrics, Inc.*, 271 F. 2d 402 (2 Cir. 1959), *cert. granted*, 362 U. S. 909 (1960), *dismissed pursuant to Rule 60*, 364 U. S. 801 (1960) we have held that an arbitration agreement is separable from the contract within which it is contained. As it

is separable, we have held that when there is no allegation of fraud in the inducement to enter into the agreement to arbitrate any controversies or claims arising out of, or relating to, the agreement of which the arbitration agreement is a part, and which agreement is allegedly entered into by fraudulent inducement, the resolution of whether there was in fact fraud in the inducement is properly the province of the arbitrations and not of the court. *Robert Lawrence Company* v. *Devonshire Fabrics, Inc., supra* at 410; *El Hoss Engineer. & Transport Co.* v. *American Ind. Oil Co.*, 289 F. 2d 346, 349 (2 Cir. 1961); *Petition of Kinoshita & Co.*, 287 F. 2d 951 (2 Cir. 1961); *Amicizia Societa Navegazione* v. *Chilean Nitrate & Iodine Sales Corp.*, 274 F. 2d 805 (2 Cir.), *cert. denied*, 363 U. S. 843 (1960).

Here the arbitration provision incorporates the standard clause recommended by the American Arbitration Association, is broad and comprehensive, and, under the law of this circuit, would most assuredly cover a dispute over fraudulent inducement. See *Petition of Kinoshita & Co., supra.*

Appellant would distinguish *Robert Lawrence* v. *Devonshire* on the ground that there the party seeking the stay of arbitration had sued for damages for a contract breach while here appellant seeks a rescission. We recognize the distinction, but point out that, though the recovery sought in the two cases may differ, the ground upon which each recovery is sought is that of the alleged fraudulent inducement, an issue we hold is one for the arbitrators to resolve. See also *Fabrex Corp.* v. *Winard Sales Co.*, Sup. Ct. New York County, 200 N. Y. S. 2d 278 (1960).

Appellant also maintains that, inasmuch as appellee served a notice to arbitrate pursuant to a provision of New York law prior to appellant's institution of suit in a federal court, appellee's federal court motion to compel arbitration filed in the federal court appellant chose, does not cause federal law to govern as to whether the issue of alleged fraud in the inducement should be adjudicated in court or resolved by arbitrators, but that New York law should control.

There is no merit in this contention. We quote *Robert Lawrence Co.* v. *Devonshire Fabrics, Inc., supra* at 409, and

> "... hold that the Arbitration Act in making agreements to arbitrate 'valid, irrevocable, and enforceable' created national substantive law clearly constitutional under the maritime and commerce powers of the Congress and that the rights thus created are to be adjudicated by the federal courts whenever such courts have subject matter jurisdiction, *including diversity cases,* just as the federal courts adjudicate controversies affecting other substantive rights when subject matter jurisdiction over the litigation exists. We hold that the body of law thus created is substantive not procedural in character and that it encompasses questions of interpretation and construction as well as questions of validity, revocability and enforceability of arbitration agreements affecting interstate commerce or maritime affairs, since these two types of legal questions are inextricably intertwined." (Emphasis supplied.)

El Hoss Engineer. & Transport Co. v. *American Ind. Oil Co., supra; Petition of Kinoshita & Co., supra; Metro Industrial Painting Corp.* v. *Terminal Const. Co.*, 287 F. 2d 382 (2 Cir. 1961) at 384-385, and see separate concurring opinion of Judge Lumbard at 385 ff.; *Amicizia Societa Navegazione* v. *Chilean Nitrate & Iodine Sales Corp., supra.*

Appellee has moved for a grant to it of double costs, damages, counsel fees and expense reimbursement, all pursuant to 28 U. S. C. §1912, citing *Chatham Shipping Co.* v. *Fertex S.S. Corp.*, 352 F. 2d 291, 294-95 (2 Cir. 1965), and *A/S Krediit Pank* v. *Chase Manhattan Bank*, 303 F. 2d 648 (2 Cir. 1962). Appellee's motion is not wholly ill-founded, but we believe it better to deny it, for arbitration should now proceed promptly.

Appeal dismissed.

Appendix A—Opinions and Orders

Order of United States Court of Appeals for the Second Circuit, Dismissing Appeal

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the twelfth day of May, one thousand nine hundred and sixty-six.

Present:

HON. STERRY R. WATERMAN,
HON. LEONARD P. MOORE,
HON. WILFRED FEINBERG,
Circuit Judges.

[SAME TITLE]

A motion having been made herein by counsel for the appellee to dismiss the appeal for frivolousness and for other and further relief,

Upon consideration thereof, it is

Ordered that said motion be and it hereby is granted and that the appeal from the United States District Court for the Southern District of New York be and it hereby is dismissed with costs to the appellee.

A. DANIEL FUSARO
Clerk

Appendix B—Text of Statutes Involved

Statutes

FEDERAL ARBITRATION ACT

"§2. *Validity, irrevocability, and enforcement of agreements to arbitrate.*

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."

"§3. *Stay of proceedings where issue therein referable to arbitration.*

If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration."

"§4. *Failure to arbitrate under agreement; petition to United States Court having jurisdiction for order to compel arbitration; notice and service thereof; hearing and determination.*

A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any Court of the United States which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties for an order directing that such arbitration proceed in the manner provided for in such agreement . . . The Court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply herewith is not in issue, the Court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement . . . If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the Court shall proceed summarily to the trial thereof . . . When such an issue is raised, the party alleged to be in default may, except in cases of admiralty, on or before the return day of the notice of application, demand a jury trial of such issue . . ."

New York Civil Practice Law and Rules

"7503. *Application to compel or stay arbitration; stay of action; notice of intention to arbitrate.*

(c) Notice of intention to arbitrate. A party may serve upon another party a notice of intention to arbitrate, spe-

cifying the agreement pursuant to which arbitration is sought and the name and address of the party serving the notice, or of an officer or agent thereof if such party is an association or corporation, and stating that unless the party served applies to stay the arbitration within ten days after such service he shall thereafter be precluded from objecting that a valid agreement was not made or has not been complied with and from asserting in court the bar of a limitation of time. Such notice shall be served in the same manner as a summons or by registered or certified mail, return receipt requested. An application to stay arbitration must be made by the party served within ten days after service upon him of the notice or he shall be so precluded. Notice of such application shall be served in the same manner as a summons or by registered or certified mail, return receipt requested.

Appendix C—Exhibits

Complaint

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

[SAME TITLE]

Plaintiff Demands Trial by Jury

Plaintiff, complaining of the defendant, by its attorney, ROBERT P. HERZOG, respectfully shows and alleges:

FIRST: Jurisdiction is founded on a diversity of citizenship and amount. Plaintiff is a corporation incorporated under the laws of the State of Maryland, having its place of business in the State of Maryland, and the defendant is a corporation incorporated under the laws of the State of New Jersey, having its principal place of business in a state other than the State of Maryland. The matter in controversy exceeds, exclusive of interest and costs, the sum of $10,000.00.

SECOND: That on October 7, 1964, plaintiff, Prima Paint Corporation (hereinafter referred to as "Prima"), and defendant, Flood & Conklin Mfg., Co. (hereinafter referred to as "F & C"), executed an agreement in writing, which was contemporaneously supplemented and adjusted, wherein and whereby, *inter alia*, Prima employed F & C and F & C agreed to work for Prima for a six year period. A copy of the said agreement, without its contemporaneous supplements and adjustments, is hereto annexed as Exhibit A and made a part hereof, as if fully set forth at length.

THIRD: That by the terms of the aforesaid agreement, F & C promised to serve Prima in an advisory and consultative capacity to the extent that Prima may reasonably require, in connection with the formulae, manufacturing operations, sales and servicing of Prima's trade sales accounts.

FOURTH: That in consideration of the foregoing promise of F & C, Prima agreed to pay to F & C a percentage of all its receipts from customers of F & C or customers who purchased F & C's products, as defined in the said agreement, for the next six years, the total aggregate to F & C, however, not to exceed $225,000.00.

FIFTH: Among the provisions of the said agreement, it was provided that any controversy or claim arising therefrom would be settled by arbitration in the City of New York.

SIXTH: That upon the urging of F & C, its agents, servants, employees or attorneys, Prima was fraudulently induced to accelerate the execution and closing date of the said agreement herein, from October 21, 1964 to October 7, 1964.

SEVENTH: That prior to the execution of the aforesaid agreement, F & C, its agents, servants, employees, or attorneys, represented and stated to Prima that F & C was in all respects a solvent corporation and able to perform all of the terms and conditions of the said agreement on its part to be performed.

EIGHTH: That the said representations and statements made by F & C, its servants, agents, employees or attorneys, that it was in all respects a solvent corporation and able to perform all the terms and conditions of the agreement on its part to be performed, were false and fraudulent when made and that F & C, its agents, servants, employees, or attorneys, knew or had reasonable cause to know that the representations and statements were false and fraudulent when made.

NINTH: That in truth and in fact, F & C was an insolvent corporation, and its agents, servants, employees or attorneys knew or had reasonable cause to know same, and upon information and belief, had consulted attorneys with regard to or had participated and prepared applications for a proceeding pursuant to the insolvency provisions of Chapter XI of the Bankruptcy Act.

TENTH: That on or about October 14, 1964, F & C filed a voluntary petition under the provisions of Chapter XI, Section 322 of the Bankruptcy Act in the United States District Court for the District of New Jersey.

ELEVENTH: That Prima, not knowing the truth with regard to the said statements and representations, but believing them to be true, and in reliance thereon, was thereby induced to accelerate the closing date thereof and execute the agreement referred to herein as Exhibit A.

TWELFTH: That Prima relied on the aforesaid false and fraudulent representations and statements that F & C

was in all respects a solvent corporation and able to perform all the terms and conditions of the agreement on its part to be performed, and Prima would not have accelerated the date of the execution, nor would Prima have entered into the said agreement hereinabove set forth, but for the false and fraudulent representations and statements made by F & C.

THIRTEENTH: That plaintiff has no adequate remedy at law.

WHEREFORE, plaintiff demands judgment that the agreement herein dated October 7, 1964, be rescinded, declared null and void, that Prima and F & C be made whole, and that the plaintiff have such other, further and different relief as to the Court may seem just and proper, together with the costs and disbursements of this action.

ROBERT P. HERZOG
Attorney for Plaintiff
Office & P. O. Address
280 Madison Avenue
New York, New York, 10016

PLEASE TAKE NOTICE, that pursuant to the provisions of the Rules of Civil Procedure, Prima Paint Corporation, plaintiff herein, demands a trial by jury of the issues raised herein.

Appendix C—Exhibits

Consulting Agreement

CONSULTING AGREEMENT dated October 7, 1964, between PRIMA PAINT CORPORATION, a Maryland corporation ("Prima"), and FLOOD & CONKLIN MFG. Co., a New Jersey corporation ("F&C").

Prima desires to secure the services of F&C on an advising and consulting basis, in connection with the takeover and operation of the Trade Sales business formerly conducted by F&C, and F&C is willing to perform such services.

NOW, THEREFORE, in consideration of the premises and of the mutual agreements hereinafter set forth, the parties hereto agree as follows:

1. *Employment and Term.* Prima hereby employs F&C and F&C agrees to work for Prima, on the terms and conditions hereinafter set forth, for a six year period (hereinafter called the "Consulting Period") commencing at the date hereof and ending at the close of business on October 7, 1970.

2. *Services.* During the Consulting Period, F&C shall serve Prima in an advisory and consultative capacity to the extent Prima may reasonably require, in connection with the formulae, manufacturing operations, sales and servicing of Prima Trade Sales accounts. It is agreed that such services shall be performed by Jerome K. Jelin,

Chairman of F&C except in the event of his death or disability, and F&C agrees to employ him for such purpose. Any out of pocket expenses incurred at Prima's request shall be reimbursed to F&C.

3. *Covenant Not to Compete.* F&C agrees that for a period of seventy-two (72) months from and after the date hereof it will not make any Trade Sales of paint or paint products (a) in the territory in which it was making such trade sales within the year prior to this date, or (b) to any of the customers who purchased Trade Sales paint or paint products from F&C within the said one year period prior to this date.

4. In consideration of F&C's agreement not to compete in trade sales of paint and paint products and in consideration further of F&C's agreement to act as a consultant to Prima, Prima agrees to make payments to F&C in the amount and under the terms and conditions as follows (it being understood and agreed that wherever reference is made to "Prima" herein it shall include Prima as well as all of its subsidiaries and/or affiliates engaged in the paint business):

(a) Prima agrees to pay F&C an amount equal to Five (5%) percent of all of its receipts from customers of F&C listed in Exhibit "A" hereto, and Two (2%) percent of its receipts from those listed in Exhibit "B" hereto, in either case arising out of the sale of any and all paint and/or paint products by Prima to those so listed in Exhibits "A" and "B" during the term hereof, whether

the paint and/or paint products so sold bears the labels, trade names heretofore used by F&C or any other labels, trade names or designation.

(b) Prima agrees during the term hereof to pay F&C an amount equal to Five (5%) percent of all of its receipts from its customers other than those covered by subdivision (a) who purchase F&C products (as hereinbelow defined), and except that where such customers are supermarkets other than those listed in Exhibit "B" hereto, Prima shall only pay to F&C Two (2%) percent of its receipts from said supermarket customers. As used herein, F&C products shall mean any and all paint and/or paint products sold under the trade names, brand names, trade marks, formulae, patents and/or labels sold to Prima pursuant to Agreement with F&C dated August 21, 1964.

(c) Starting the first day of the eleventh month after the closing date, namely, September 1, 1965, and on the first day of every month thereafter during the term hereof, Prima shall pay the sum of $2,500.00 per month to F&C as an advance against the percentage payments described in subparagraphs "(a)" and "(b)" of this Paragraph "4". If, however, the sales volume encompassed by subparagraphs "(a)" and "(b)" accounts shall fall below $600,000. in any full calendar year beginning with the year 1965, then Prima's obligation under this subparagraph "(c)" shall in the immediately succeeding year be reduced by $500. per month for each $100,000., or fraction thereof, of sales by which the aggregate sales falls below $600,000. If the sales in any later years increase and exceed $600,000.

then the original amount to be paid monthly shall be resumed. By way of illustration: if such sales in the calendar years 1966, 1967 and 1968 should aggregate $450,000., $750,000. and $525,000., respectively, then the monthly advances to be paid in the years 1967, 1968 and 1968 shall be $1,500.00, $2,500.00, and $2,000.00 respectively.

(d) Beginning on the fifteenth day of February, 1965 and on the fifteenth day of every third month thereafter, Prima shall render to F&C a statement verified by Prima's chief financial officer, which statement shall (i) set forth the status of the account between the parties pursuant to "(a)" and "(b)" above, and (ii) itemize all sales made, and all payments received, by Prima, by customer name and amounts during the preceding three (3) months. The initial statement rendered hereunder shall cover the entire period from the closing date to the end of December, 1964.

(e) On March 1, 1965 and every March 1st thereafter, and then finally on the first day of the 74th month after the closing date, Prima shall render to F&C a statement certified by a certified public accountant setting forth the status of account between the parties covering the preceding calendar year (the statement rendered on the 74th month shall cover only the period beginning with the last preceding January 1st until the end of the term hereof). At the time each statement required to be made under this subparagraph "(e)" is rendered, there shall be a cash settlement of the account between the parties.

(f) For the purposes of computing the amounts required to be paid under subparagraphs "(a)" and "(b)"

hereunder, the amount of Prima's receipts shall be deemed to be the amount actually received plus any amounts by which the basic sales price has been reduced because of credits, allowances or waivers which relate directly or indirectly to allowances for advertising.

(g) The payments by Prima under "(a)" and "(b)" hereof shall cease when the aggregate amount paid to F&C equals $225,000. or upon the expiration of the term hereof, whichever is the first to occur.

(h) Notwithstanding the expiration of the term hereof, Prima shall continue to make payments to F&C based on the percentages set forth in subparagraphs "(a)" and "(b)" for all payments received by Prima after the expiration date arising out of sales encompassed by said subparagraphs which were shipped before the expiration date. On the tenth of the second month following the expiration date, and on the tenth of each month thereafter, Prima shall account and make payments to F&C under this subparagraph "(h)" covering all applicable receipts of the preceding months or month, as the case may be.

(i) Prima shall maintain for a period of seven (7) years from the date hereof all necessary books and records to substantiate the sales and receipts reports provided for herein. F&C shall have the right and authority to audit or otherwise verify Prima's sales and receipts and to that end shall have access to all relevant records of Prima.

5. *Notices.* Any notice to be given to F&C hereunder shall be sent by registered or certified mail addressed to it at 136 Chestnut Street, Newark 5, New Jersey, and c/o Wachtel & Michaelson, 575 Madison Avenue, New York, New York 10022, and any notice to be given to Prima hereunder shall be sent by registered or certified mail addressed to it at 819 South Caroline Street, Baltimore, Maryland, and c/o Charles M. Cahn, Jr., 912 Fidelity Building, Baltimore, Maryland.

6. *Miscellaneous.* (a) This Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns.

(b) This Agreement embodies the entire understanding of the parties on the subject matter and no amendment or modification of it shall be valid or binding upon the parties unless in writing.

7. Notwithstanding anything to the contrary contained herein, if at any time prior to the full completion of the payments due F&C from Prima, as set forth in paragraph "4" hereof, (i) there shall be filed against Prima in any court, pursuant to any Federal or state statute, a petition in bankruptcy or insolvency or for reorganization or for the appointment of a receiver or trustee of all or substantially all of Prima's property, and such petition shall not be stayed, dismissed or vacated within forty-five (45) days after the filing thereof, or (ii) Prima shall itself file as aforesaid a petition in bankruptcy or insolvency or for reorganization under any Federal or state statute in aid

of debtor or for the appointment of a receiver or trustee of all or a substantial part of its property, or (iii) Prima shall make an assignment for the benefit of creditors, or (iv) the estate or interest of Prima in the trade names and labels and/or the customer accounts and/or the good will represented thereby, shall be levied upon or attached in any proceeding and such process is not vacated or discharged or adequately bonded by Prima within twenty (20) days after such levy or attachment, or (v) Prima fails to make any payments due to F&C as provided for in Paragraph "4" and within thirty (30) days after notice that such payments are delinquent, fails to make such payment or fails to adequately bond such amount or pay such amount in escrow to Messrs. Harry H. Wachtel and Charles M. Cahn, Jr., jointly, then and in any of such events there shall immediately become due to F&C from Prima the sum of $225,000., less any payments made pursuant to Paragraph "4", and in addition, all rights, estate or interest of Prima in and to the customer accounts set forth in Exhibits "A" and "B" annexed hereto, the trade names and labels and formulae comprising the F&C products shall automatically revert at once to F&C and shall once again become the absolute property of F&C without liability of any kind whatsoever on F&C's part to return or repay any portion of the payments received by F&C from Prima hereunder. In any such event, no person, firm, corporation or other entity, except F&C shall have or obtain the aforesaid rights, estate or interest in and to said customer accounts, trade names and labels, and formulae or in and to the right to use said names or labels for the purpose set forth above.

8. *Arbitration.* Any controversy or claim arising out of or relating to this Agreement, or the breach thereof, shall be settled by arbitration in the City of New York, in accordance with the rules then obtaining of the American Arbitration Association, by three arbitrators, one of whom shall be an attorney-at-law and one of whom shall be a certified public accountant, and judgment upon the award rendered may be entered in any Court having jurisdiction thereof. The costs of arbitration shall be shared equally by Prima & F&C.

9. *Miscellaneous.* (a) Prima agrees that it will not sell, transfer or dispose of any of the customer accounts set forth in Exhibits "A" and "B" annexed hereto, or the trade names and labels and formulae comprising the F&C products to any person, firm, or company unless such person, firm or company expressly undertakes to assume the obligation of Prima hereunder. In the event of any violation of this Agreement, then the provision of paragraph 7 shall apply.

(b) The individuals, partnerships or corporations listed in Exhibits "A" and "B", shall for all purposes hereof be deemed to include any successor entity thereto whether the same arises from merger, consolidation, combination or otherwise.

(c) This Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns.

(d) This Agreement embodies the entire understanding of the parties on the subject matter and no amendment or modification of it shall be valid or binding upon the parties unless in writing.

IN WITNESS WHEREOF, the parties hereto have caused this Purchase Agreement to be duly executed on the day and year first above written.

FLOOD & CONKLIN MFG. CO.

By: /s/ JEROME K. JELIN
Jerome K. Jelin, Chairman

ATTEST:

/s/ ARTHUR M. GOLDEN
Arthur M. Golden, President

PRIMA PAINT CORPORATION

By: /s/ (Illegible)

ATTEST:

/s/ (Illegible)

Appendix C—Exhibits

Demand for Arbitration

October 25, 1965

Prima Paint Corporation
819 So. Caroline Street
Baltimore, Maryland

Prima Paint Corporation
c/o Charles M. Cahn, Jr.
912 Fidelity Building
Baltimore, Maryland

PLEASE TAKE NOTICE, under Section 7503, Subdivision (c) of the Civil Practice Law and Rules of the State of New York, that the undersigned, pursuant to the provisions of a contract dated October 7, 1964, which agreement provides as follows:

> "8. *Arbitration.* Any controversy or claim arising out of or relating to this Agreement, or the breach thereof, shall be settled by arbitration in the City of New York, in accordance with the rules then obtaining of the American Arbitration Association, by three arbitrators, one of whom shall be an attorney-at-law and one of whom shall be a certified public accountant, and judgment upon the award rendered may be entered in any Court having jurisdiction thereof. The costs of arbitration shall be shared equally by Prima & F&C."

hereby demands arbitration thereunder.

NATURE OF DISPUTE:

Failure by Prima Paint Corporation to make payments to Flood & Conklin Mfg. Co. in the sum of $2,500 on the first day of each month, commencing September 1, 1965,

pursuant to the terms of a written contract between the parties dated October 7, 1964.

CLAIM OR RELIEF SOUGHT:

An award that Prima Paint Corporation is liable to Flood & Conklin Mfg. Co. for payments of $2,500 per month commencing as of September 1, 1965, and continuing thereafter as set forth in the aforesaid contract between the parties dated October 7, 1964.

PLEASE TAKE FURTHER NOTICE, that unless within ten days after service of this Notice of Intention to Arbitrate, you apply to stay the arbitration herein, you shall thereafter be precluded from objecting that a valid agreement was not made or has not been complied with and from asserting in court the bar of a limitation of time.

HEARING LOCALE REQUESTED:

New York City (Pursuant to the terms of the Agreement).

You are hereby notified that copies of our Arbitration Agreement and of this Demand are being filed with the American Arbitration Association in its New York Regional Office, with the request that it commence the administration of the arbitration.

Yours, etc.

WACHTEL & MICHAELSON
Attorneys for Flood & Conklin Mfg. Co.
Office & P. O. Address
575 Madison Avenue
New York, NY 10022

Appendix D

Excerpts From Petition for Writ of Certiorari in *Lawrence* v. *Devonshire*

• • •

REASONS FOR GRANTING THE WRIT

1. The Court of Appeals has decided an important question of federal law which has not been, but should be, settled by this Court.*

The court below not only decided (a) that both the validity and the interpretation of arbitration clauses in interstate contracts were governed by a newly evolved concept of federal substantive law of arbitration, but, also, (b) recognized that this conclusion required that all state courts—though operating under their own arbitration laws and laws of contract—must henceforth adjudicate questions of the validity and interpretation of arbitration clauses in all interstate contracts in accordance with Federal law and Federal decisions. Said the court below (271 F. 2d at 407; pp. A 24--25):

> "... Congress based the Arbitration Act in part on its undisputed substantive powers over commerce and maritime matters ... Section 2 declaring that

---

* The court below said (271 F. 2d at 404; p. A 19):

> "The case involves questions left open by the Supreme Court in Bernhardt v. Polygraphic Co. of America, Inc., 1956, 350 U. S. 198, 76 S. Ct. 273, 100 L. Ed. 199, and these questions are interesting and important. The basic inquiry must be whether the validity and interpretation of the arbitration clause of the contract in this case is governed by Federal law, i.e., the Federal Arbitration Act, or by local law."

> arbitration agreements affecting commerce or maritime affairs are 'valid, irrevocable, and enforceable' . . . must mean that arbitration agreements of this character, previously held by state law to be invalid, irrevocable or unenforceable are now made 'valid, irrevocable and enforceable.' This is a declaration of national law equally applicable in state or federal courts."

The importance of the decision is obvious.* The decision is important not only to the textile industry out of which the present case arises and in which arbitration clauses are all but universal,** but also because it both cuts across the whole field of arbitration law and propounds a novel principle that can drastically affect and create confusion as to the powers of federal and state courts.

The court below in deciding the "interesting and important" questions it considered that this Court had left open in *Bernhardt* v. *Polygraphic Co. of America, Inc.*, 350 U. S. 198 (1956), reached a conclusion contrary to

---

* The New York Times of the day following the decision, October 29, 1959, carried a front page story to the effect that the decision "was believed to represent a revolutionary concept in interpreting the intention of Congress in enacting the Federal Arbitration Act." The decision was reported in New York City radio news broadcasts on the evening of the decision and on the morning following.

** The American Arbitration Association records show that 652 commercial arbitrations were conducted by it alone in 1957; 525 private civil contract cases based on diversity of citizenship were instituted in the six United States District Courts for the Second Circuit in the fiscal year ending June 30, 1959.

the central principle that this Court regarded as dispositive of that case (p. 203):

> "If the Federal court allows arbitration where the state court would disallow it, the outcome of litigation might depend on the courthouse where a suit is brought."

For the court below acknowledged (271 F. 2d at 412, p. A 34):

> "We note that were we compelled to apply New York law to the problems involved in this case we would have been forced to arrive at a contrary conclusion."

On the one hand this Court in the *Bernhardt* case treated the question as a part of the law of remedies which law, because it could affect the outcome of the litigation, would have to be determined in accordance with the law of the state in which the litigation was pending, including the Conflict of Laws rules of that state. On the other hand the court below has squarely held that the Federal Arbitration Act is substantive in its application to interstate contracts and therefore preempts the interpretation of all arbitration clauses (but only such clauses) in contracts involving interstate commerce. The court below, indeed, explicitly disagreed with the view of Mr. Justice Frankfurter, expressed in his concurring opinion in the *Bernhardt* case, that the Federal Arbitration Act should be held wholly inapplicable in diversity cases.

The decision below thus has invented a novel and unworkable principle under which two laws would separately apply to different parts of the same contract. State law, though generally the source of contract rights, would be

substantively displaced as to part of the contract. More than that, state courts would have to substitute for their own law as to such part, a fresh body of federal contract precedents to be gleaned from Courts in 86 Federal Districts in 50 states, Courts of Appeals in eleven circuits and, ultimately, from necessarily infrequent clarifying decisions in this Court.

Thus, the decision below importantly concerns the definition of state-created rights as against federally-created rights, the essential nature of the Federal Arbitration Act in its relation to commercial contracts involving interstate commerce as remedial or substantive law, and the scope and application of the principles that this Court was thought to have settled in the *Bernhardt* case.

2. The Court of Appeals has rendered a decision directly in conflict with the decisions of the Court of Appeals for the Sixth Circuit in *American Airlines, Inc.* v. *Louisville and Jefferson County Air Board*, 269 F. 2d 811 (1959) and the Ninth Circuit in *Ross* v. *Twentieth Century-Fox Film Corporation*, 236 F. 2d 623 (1956).

The Circuit Court of Appeals for the Sixth Circuit in the *American Airlines* case held, a month before the decision below was rendered, that in determining whether an arbitration clause contained in a lease of airport facilities was valid, the District Court had been right in applying local state law rather than federal law, notwithstanding that the transaction involved commerce among the states.*

---

* Apparently the Second Circuit Court of Appeals did not have the advantage of considering the opinion in the *American Airlines* case as it is not cited.

Appendix D

The decision in the case at bar is in acknowledged conflict with the decision of the Ninth Circuit Court of Appeals in *Ross* v. *Twentieth Century-Fox Film Corporation*, 236 F. 2d 632 (1956). The court there held that "even if this [interstate] contract is of the sort contemplated by Section 3 of Title 9, the interpretation of the contract is still a matter of California law, and it must be determined by reference to that law whether the contract contains language which amounts to a provision for arbitration." The court in the case at bar put the *Ross* case aside as being founded on an erroneous reading of this Court's decision in the *Bernhardt* case (271 F. 2d at 409; p. A 27).

3. The decision of the court below has overturned a long-standing construction of Federal law and reached a conclusion at variance with earlier decisions in the Second and other circuits in its conception of a new principle of law applicable to the enforceability of arbitration clauses.

For the first time in 34 years the Federal Arbitration Act has been interpreted so as to compel arbitration of a contract obtained through fraud.

The Court in the case at bar has in effect overturned the earlier decision of the Second Circuit in *Kulukundis Shipping Co.* v. *Amtorg Trading Corp.*, 126 F. 2d 978 (2d Cir. 1942), a case involving denial of the making of a charter party containing an arbitration clause. The earlier court held (a) that arbitrators could not—without impermissible self-stultification—pass upon the question whether the contract to which they owed their appointment had validly come into existence, and (b) that the

Federal Arbitration Act clearly did not contemplate arbitration of a controversy over the existence of the contract embodying the arbitration agreement (126 F. 2d at 986).

The court below brushed this decision aside as dealing with a case in which one party altogether denied that any contract had been made (271 F. 2d at 411, p. A 33) but that "distinction" equally comprehends any case like the present one, of fraud in the inducement of an entire transaction.

The court below openly disagreed with and put to one side as unconsidered the decision of the Sixth Circuit Court of Appeals in *Kentucky River Mills* v. *Jackson*, 206 F. 2d 111 (1953) which treated the issue of fraud in inducing a contract as an issue that had to be judicially litigated and one which could not be made the subject of arbitration (271 F. 2d at 411, p. A 33).

The court in the case at bar is also in apparent disagreement with other cases, which have assumed that the Federal Arbitration Act does not require arbitration where the contract containing the alleged agreement to arbitrate has itself been induced by a fraud. *Reynolds Jamaica Mines, Ltd.* v. *La Societe Navale Caenaise*, 239 F. 2d 689 (4th Cir. 1956); *Almacenes Fernandez, S.A.* v. *Godoletz*, 148 F. 2d 625, 628 (2d Cir. 1945); *McElwee-Courbis Construction Co.* v. *Rife*, 133 F. Supp. 790, 794 (M. D. Pa. 1955).

It is plain therefore that the decision of the court below on the arbitrability of fraud in the inducement is contrary to the gist and trend of the decisions in other circuits, including earlier decisions in the court below and overturns a substantial body of cases.

Appendix D

4. The court below manifestly misinterpreted Section 2 of the Federal Arbitration Act in developing its novel doctrine that an arbitration clause contained in a contract is "separable" from the contract of which it is a part.

This novel doctrine is directly in conflict with *Kulukundis* which held 126 F. 2d 985-6 that an arbitration clause is an integral part of the contract.

In so disagreeing, the court found that it is not enough that there be substance to petitioner's "charge that the contract to deliver merchandise of a certain quality was induced by fraud" but that petitioner—beyond that—had to show that it had been induced—specifically—to sign the arbitration clause itself by a fraud directed to that clause.

The Circuit Court concluded, as a matter of law on the facts before it, that petitioner had not been induced by any particular fraud directed to arbitration matters to assent to the inclusion of that clause in the contract. The court concluded—therefore—that petitioner could not be relieved of the obligation to arbitrate.

If it were correct, the decision would be of far-reaching importance. The court below was consciously rejecting the argument that if "the entire transaction was induced by fraud . . . the arbitration provision necessarily falls with the rest" (271 F. 2d at 411, p. A 32). But assent to a contract is not partible, nor is is distributable to clauses of a contract, when the reality is that no part of the contract would have been entered into at all had the fraud gone uncommitted. The court below sought to translate the structure of the Federal Arbitration Act into a far-reaching principle—that fraud warrants only the rescission of

those parts of a contract to which the misrepresentations specifically relate and does not to any other extent negate the reality of the contract as a whole.

The novel principle proposed is as false in reason as it is in its realism. The fraud practised to induce a transaction permeates it. It takes less than an instant of reflection to realize that men do not consciously and separably agree to arbitrate the possibility that the entire transaction in which they are engaging has been the product of a fraud upon them. Realistically their assent to arbitration is confined by the assumption that the transaction is founded in candid commercial dealing and will operate within the limits of contractual obligations genuinely arrived at.

In the market place the arbitration clause of a contract is never considered separately by business men much less signed separately. In almost every textile case it is a "small print" clause on the reverse side of the order. To suppose that there could ever be a fraud as to such a clause alone separate and apart from the entire contract is to ignore the true realities of the business world.

It is imperative therefore that the important question of federal law arising from the novel approach of the Circuit Court in the case at bar and overturning long standing precedent be resolved by this court.

* * *

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

PRIMA PAINT CORPORATION,
Petitioner,

v.

FLOOD & CONKLIN MFG. CO.,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION

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RUBIN, WACHTEL, BAUM & LEVIN,
Of Counsel.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

No. 343

PRIMA PAINT CORPORATION,

Petitioner,

v.

FLOOD & CONKLIN MFG. CO.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION

Opinions Below

The opinion of the District Court (Pet. 1a-4a)[1] is not reported. The opinion of the Court of Appeals is reported at 360 F. 2d 315.

Jurisdiction

The order of the Court of Appeals was entered on May 12, 1966 (Pet. 14a). The petition for a writ of

1. "Pet." references are to the appendix to the brief of petitioner. "Exhibit" references are to exhibits to the motion papers in the court below.

certiorari was filed on July 14, 1966. The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1).

Question Presented

Whether, where a contract involving interstate commerce provides that "any controversy or claim arising out of or relating to this Agreement or the breach thereof, shall be settled by arbitration * * *", a charge of fraud in the inducement of such contract is required to be settled by arbitration, as held by both courts below.

Statement of the Case

The underlying facts may be summarized as follows. On October 14, 1964, petitioner, a Maryland corporation, entered into a written agreement (the "Agreement") with respondent, a New Jersey corporation (Pet. 5c-13c). That Agreement, as petitioner's president accurately stated,

> "* * * contemplated and intended an orderly transfer of the assets of the defendant [respondent herein] to the plaintiff [petitioner herein], and further contemplated and intended that the defendant would consult, advise, assist and help the plaintiff so as to insure a smooth transition of manufacturing operations to Maryland from New Jersey together with the sales and servicing of customer accounts and the retention of the said customers" (Exhibit IV, matter in brackets added).

In return for the present transfer of its assets and for the consultative and advisory assistance it was to render, respondent was to be paid by petitioner a specified percentage of the net proceeds of all sales made by petitioner to respondent's former customers. Although the Agreement provided that the aggregate of all such

payments would in no event exceed $225,000, payable over a six year period, no minimum amount was guaranteed (Pet. 9c). The first payment was due on September 1, 1965, approximately eleven months after the execution of the Agreement and the transfer of the assets thereunder (Pet. 7c). On September 17, 1965, seventeen days after the first payment was due, and over a year after the Agreement was made, petitioner deposited the amount then due with an escrow agent and asserted certain "breaches" of the Agreement by respondent (Exhibit II-3). Respondent thereupon initiated arbitration proceedings, pursuant to paragraph 8 of the Agreement, which states:

> "8. *Arbitration.* Any controversy or claim arising out of or relating to this Agreement, or the breach thereof, shall be settled by arbitration in the City of New York, in accordance with the rules then obtaining of the American Arbitration Association by three arbitrators, one of whom shall be an attorney-at-law and one of whom shall be a certified public accountant, and judgment upon the award rendered may be entered in any Court having jurisdiction thereof. The costs of arbitration shall be shared equally by Prima & F&C" (Pet. 12c).

Three days before the expiration of petitioner's time to appear, answer or otherwise move with regard to the demand for arbitration (its time to do so having been extended by respondent), petitioner commenced an action in the District Court seeking to rescind the Agreement on the ground that petitioner was fraudulently induced to enter into the Agreement (Pet. 1c).

Petitioner then moved to stay the arbitration, pending the adjudication of its action, and respondent in turn

moved to stay the action pending the arbitration. The District Court, disposing of both motions together, granted respondent's motion and ruled that the court action should be stayed, and that the arbitration should proceed (Pet. 1a-6a).

Petitioner thereupon appealed to the Court of Appeals, an appeal which respondent moved to dismiss as frivolous. The Court of Appeals granted respondent's motion and dismissed the appeal (Pet. 7a-14a).

Argument

The decision of the court below dismissing the appeal, and hence affirming the District Court's order directing arbitration, is clearly correct. It does not warrant review by this Court. Petitioner errs when it urges that the reasons which prompted this Court to grant certiorari in *Robert Lawrence Company* v. *Devonshire Fabrics, Inc.*, 271 F. 2d 402 (2nd Cir. 1959), *cert. granted*, 362 U. S. 909 (1960), *dismissed pursuant to Rule 60*, 364 U. S. 801 (1960) are present in the instant case.

The primary issue in *Robert Lawrence* was whether federal law or state law should govern in ruling upon the arbitrability of a charge of fraud in the inducement of the contract, where the contract at issue involved interstate commerce and contained a provision for arbitration. In *Robert Lawrence* the Court of Appeals, in applying federal law and ordering arbitration, expressly noted (at 271 F. 2d p. 412) that New York law would have required a result contrary to the one which it reached, citing *Matter of Wrap-Vertiser Corp.* (*Plotnick*), 3 N. Y. 2d 17, 163 N.Y.S. 2d 639, 143 N.E. 2d 366 (1957). However, in the ensuing years, the course of New York's decisions regarding the very same underlying issue of

arbitrability has decisively changed. Thus where fraud in the inducement of a contract is now charged, the state courts reach the same conclusion as did the Court of Appeals in *Robert Lawrence,* namely that such question is properly cognizable by the arbitrators and is to be resolved in arbitration. This was recognized by the Court of Appeals in *In re Kinoshita & Co.,* 287 F. 2d 951, 953 (2nd Cir., 1961), wherein it was observed that:

> "Recent decisions by the New York courts have held similar arbitration clauses sufficiently broad to include fraud in the inducement. In Amerotron Corp. *v.* Maxwell Shapiro Woolen Co., N.Y. App. Div., 1st Dept. 1957, 3 A.D. 2d 899, 162 N.Y.S. 2d 214, affirmed without opinion, 1958, 4 N.Y. 2d 772, 171 N.Y.S. 2d 111, 148 N.E. 2d 319, the clause read any 'controversy or claim arising under or in relation to this order or contract,' and it was held the alleged fraud in the inducement was a question to be decided by the arbitrators. The same phraseology was held to include a claim for rescission based upon fraudulent inducement in Fabrex Corp. *v.* Winard Sales Co., Sup. Ct, N.Y. C'ty, 1960, 23 Misc. 2d 26, 200 N.Y.S. 2d 278. Arbitration of a claim of fraudulent inducement was also ordered in M. W. Kellogg Co. *v.* Monsanto Chemical Co., N.Y. App. Div., 1st Dept. 1959, 9 A.D. 2d 744, 192 N.Y.S. 2d 869, where the clause read 'arising under or in connection with' the agreement. Thus views more favorable to arbitration appear to be making headway."

Petitioner's assertion in its recitation of the questions presented (Brief, p. 2) that state law was "concededly" contrary to the federal law applied by both courts below is inaccurate. Respondent urged before both courts below that state law and federal law would require the same result. Indeed, the court below in citing (Pet. 11a)

Fabrex Corp. v. *Winard Sales Co.*, 23 Misc. 2d 26, 200 N.Y.S. 2d 278 (Sup. Ct., N.Y. Co. 1960), acknowledged that the law of New York is consistent with the result it reached. That case held as a proposition of New York law that:

> "Where an arbitration clause is broad and all inclusive, a request for rescission, either in a pending action or in a demand for arbitration, based upon fraud in the inducement will be left for determination of the arbitrators (citations omitted)." 200 N.Y.S. 2d 278 at 280.

In the recent case of *Application of Amphenol Corporation*, 49 Misc. 2d 46, 266 N.Y.S. 2d 768 (Sup. Ct., N.Y. Co. 1965), affirmed without opinion, 25 A.D. 2d 497, 267 N.Y.S. 2d 477 (N.Y. App. Div., 1st Dept. 1966), the court stated:

> "The issue of fraudulent inducement of a contract may unquestionably be arbitrated in New York. Its arbitrability is, however, dependent upon the scope of the arbitration agreement. The single most significant case against the proposition that fraud in the inducement is arbitrable is In re Wrap-Vertiser Corp. (Plotnick), 3 N.Y. 2d 17, 163 N.Y.S. 2d 639, 143 N.E. 2d 366. In that case the court held that the arbitration clause was so narrow in scope that the question of fraudulent inducement did not come within its purview.
>
> "It is the court's opinion that the arbitration clause herein is sufficiently broad so as to indicate that it was the intention of the parties to include questions of fraud and rescission as those arbitrable. (See in re Fabrex Corp. (Winard Sales Corp.), 23 Misc. 2d 26, 200 N.Y.S. 2d 278)." 266 N.Y.S. 2d 768, 769-770.

The arbitration clause in the instant case, as noted by the court below, incorporated the standard clause recom-

mended by the American Arbitration Association (Pet. 11a) and would, under the law of New York as expressed by its courts since 1960, most assuredly cover a dispute over fraudulent inducement.

Accordingly, unlike the situation which prevailed at the time *Robert Lawrence* was decided, petitioner herein has not been prejudiced by its choice of forum. In the present state of the law, the petitioner would have been ordered to arbitrate its alleged grievances even if it had chosen to commence its litigation in the state court rather than in the federal court. Thus, the issues which were raised by *Robert Lawrence* are, insofar as the instant case is concerned, entirely moot. There is, accordingly, no real controversy present which merits review by this Court.

CONCLUSION

The petition for a writ of certiorari should be denied.

Dated: New York, N. Y.
August 12, 1966.

Respectfully submitted,

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October Term, 1966

No. 343

PRIMA PAINT CORPORATION,

Petitioner,

v.

FLOOD & CONKLIN MFG. CO.,

Respondent.

REPLY BRIEF FOR PETITIONER

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

No. 343

PRIMA PAINT CORPORATION,

Petitioner,

against

FLOOD & CONKLIN MFG. CO.,

Respondent.

REPLY BRIEF FOR PETITIONER

The opinions below, jurisdiction, questions presented, statutes involved, and statement of the case are set forth in the petition for a writ of certiorari.

Argument in Reply

1. Respondent, by its silence, has conceded the fundamental, grave and far reaching effect of the Constitutional questions sought to be reviewed, and has further conceded:

(A) That the Second Circuit Court of Appeals has reaffirmed its position on an important question of Federal law which has not been, but should be settled by this Court;

(B) That the Court of Appeals has wholly disregarded the Constitutional caveat set forth in *Bernhardt v. Polygraphic Co. of America, Inc.*, 350 U. S. 198, 76 S. Ct. 273, 100 L. Ed. 199 (1956).

(C) That with respect to the question sought to be reviewed, the decisions amongst the various Circuits are in admitted conflict.

2. Respondent admits that the question sought to be reviewed is identical with that raised in the *Robert Lawrence case,* 271 F. 2d 402 (2 Cir. 1959), cert. granted 362 U. S. 909 (1960), dismissed pursuant to Rule 60, 364 U. S. 801 (1960), and further admits that New York law would have required a contrary result citing *Wrap-Vertiser Corp. (Plotnick),* 3 N. Y. 2d 17, 163 N. Y. S. 2d 639, 143 N. E. 2d 366 (1957) (Resp. Brief pg. 4). It then seeks to dispel the aggrieved and erroneous application of Federal law complained of, by seizing upon the *dicta* of Judge Medina in the *Kinoshita case,* 287 F. 2d 951 (2 Cir. 1961), and then astutely and matter of factly concluding, that subsequent *inferior* State court decisions in the ensuing years have changed the precedent established by the *highest* Court of the State of New York.

The *Kinoshita* case, *supra,* recognized that axiomatic principles of contract law must be applied "to ascertain whether there is any factual obstacle in considering the arbitration clause." Rescission of contract for fraud in the inducement, is a factual obstacle as such, since it in effect pleads that there was no meeting of the minds, *ergo,* no contract.

3. The *Wrap-Vertiser Corp. (Plotnick)* case, *supra,* is the enunciated law of the State of New York, and all of respondent's claims and later citations contained in its brief as to the present applicable New York law, are easily distinguishable, both in fact and in law, bearing in mind that petitioner solely seeks equitable rescission of contract for fraud in the making and execution thereof.

In *Amerotron Corp.* v. *Maxwell Shapiro Woolen Co.,* 3 A. D. 2d 899, 162 N. Y. S. 2d 214 (1st Dept. 1957) affirmed without opinion, 4 N. Y. 2d 772, 171 N. Y. S. 2d 111, 148 N. E. 2d 319 (1958), the party in interest did not seek to rescind the contract, he merely sought damages for fraud, which in effect was an *action on the contract,* thereby resulting in a contrary result.

In *Fabrex Corp.* v. *Winard Sales Co.,* 23 Misc. 2d 26, 200 N. Y. S. 2d 278 (Sup. Ct. N. Y. Co. 1960), the action was entitled as a claim for fraudulent inducement, but the Court, as matter of law, found that the sole question was one of *performance of contract* and not an action for rescission for fraud in the inducement.

In *M. W. Kellogg Co.* v. *Monsanto Chemical Co.,* 9 A. D. 2d 744, 192 N. Y. S. 2d 869 (1st Dept. 1959), the Court found that this was an action involving fraudulent misrepresentations in the contract, and not one for rescission for fraudulent inducement.

In *Application of Amphenol Corporation,* 49 Misc. 2d 46, 266 N. Y. S. 2d 768 (Sup. Ct., N. Y. Co. 1965) affirmed without opinion 25 A. D. 2d 497, 267 N. Y. S. 2d 477 (1st Dept. 1966), we have the inverse situation of the party seeking rescission, attempting to enforce arbitration.

Respondent urges this Court, and would have it believe, that the Courts below in the instant proceeding, have acknowledged that the law of New York is consistent with the result reached (Resp. Brief, pp. 5-6). Nothing can be further from the truth. In the memorandum of the District Judge, not one New York case is cited, nor is New York precedent alluded to, and the same is true as to the opinion of the Circuit Court, except that one inferior New York Court case, *Fabrex Corp.* v. *Winard Sales Co., supra,* is noted.

The facetiousness of the respondent's position is amply demonstrated by his responding brief which is fraught with New York law and case citations, and thus, would seek to have this Court deny this petition upon issues outside the record, and which were not considered by the Courts below in arriving at their conclusions.

4. The issue of applicable New York law has been neither decisive nor necessary in the conclusions reached by the Courts below. The Courts below consistently applied Federal substantive law (if there be such), and it is this application of law and its constitutionality which is sought to be reviewed herein.

5. The essence of respondent's argument, that even if the Federal Courts erred in applying Federal law as opposed to State law, the petitioner has not been prejudiced thereby, is sham. It thereby admits that petitioner has not been given its day in Court. No decision has been rendered on the merits as to petitioner's and respondent's diverse contentions as regards the New York Law. The

Federal Court cannot wholly disregard the precedent established by the highest Court of the State, and each of the cases cited by respondent as manifesting a change of New York law, are easily distinguishable. This issue was never decided since the Courts below consistently and erroneously applied Federal substantive law, if there be such.

Thus, the issues raised by *Robert Lawrence, supra,* and by the instant petition are real, meritorious and require review.

CONCLUSION

It is therefore respectfully submitted that the petition for a writ of certiorari be granted.

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IN THE

Supreme Court of the United States

October Term, 1966

No. 343

PRIMA PAINT CORPORATION,
Petitioner,

against

FLOOD & CONKLIN MFG. CO.,
Respondent.

BRIEF FOR THE PETITIONER

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

No. 343

PRIMA PAINT CORPORATION,

Petitioner,

against

FLOOD & CONKLIN MFG. CO.,

Respondent.

BRIEF FOR THE PETITIONER

Citations to Opinions Below

The opinion of the United States District Court for the Southern District of New York (Croake, D.J.) is unreported and is printed herein (R. 8). The opinion in the Court of Appeals, reported in 360 F.2d 315, is printed herein (R. 45).

Jurisdiction

The jurisdiction of this court is invoked under 28 U. S. C. §1254(1). The judgment of the Court of Appeals was entered on May 12, 1966. Certiorari was granted October 17, 1966, — U. S. —, 87 S. Ct. 202, 17 L. Ed. 2d 130.

Questions Presented

1. Whether a contract wherein and whereby one of the parties is employed to serve in an advisory and consultative capacity constitutes a contract evidencing a transaction involving interstate commerce.

2. Where jurisdiction exists solely by virtue of diversity of citizenship, the Federal Arbitration Act requires the validity of an arbitration agreement contained in a contract evidencing a transaction in interstate commerce to be determined in accordance with applicable state created rights.

3. Construing the Arbitration Act as creating federal substantive law, an arbitration clause in a contract does not exist as a separable, special agreement.

4. Construing the Arbitration Act as creating federal substantive law, an arbitration clause covering "any controversy or claim arising out of or relating to this agreement, or the breach thereof", requires the question of whether the contract containing such arbitration clause has been fraudulently induced, to be in the first instance determined judicially.

Statutes Involved

The statutory provisions involved are §§2, 3 and 4 of the Federal Arbitration Act of 1925, now 61 Stat. 669 (1947), 68 Stat. 1233 (1954), 9 U.S.C. §§2, 3 and 4 and §7503(c) of the New York Civil Practice Law and Rules.

Federal Arbitration Act

§2. Validity, irrevocability, and enforcement of agreements to arbitrate.

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

§3. Stay of proceedings where issue therein referable to arbitration.

If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

§4. Failure to arbitrate under agreement; petition to United States Court having jurisdiction for order to compel arbitration; notice and service thereof; hearing and determination.

A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement

for arbitration may petition any court of the United States which, save for such agreement, would have jurisdiction under the judicial code at law, in equity, or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement. Five days' notice in writing of such application shall be served upon the party in default. Service thereof shall be made in the manner provided by law for the service of summons in the jurisdiction in which the proceeding is brought. The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. The hearing and proceedings, under such agreement, shall be within the district in which the petition for an order directing such arbitration is filed. If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof. If no jury trial be demanded by the party alleged to be in default, or if the matter in dispute is within admiralty jurisdiction, the court shall hear and determine such issue. Where such an issue is raised, the party alleged to be in default may, except in cases of admiralty, on or before the return day of the notice of application, demand a jury trial of such issue, and upon such demand the court shall make an order referring the issue or issues to a jury in the manner provided by law for referring to a jury issues in an equity action, or may

specially call a jury for that purpose. If the jury find that no agreement in writing for arbitration was made or that there is no default in proceeding thereunder, the proceeding shall be dismissed. If the jury find that an agreement for arbitration was made in writing and that there is a default in proceeding thereunder, the court shall make an order summarily directing the parties to proceed with the arbitration in accordance with the terms thereof.

New York Civil Practice Law and Rules

§7503. Application to compel or stay arbitration; stay of action; notice of intention to arbitrate.

(c) Notice of intention to arbitrate. A party may serve upon another party a notice of intention to arbitrate, specifying the agreement pursuant to which arbitration is sought and the name and address of the party serving the notice, or of an officer or agent thereof if such party is an association or corporation, and stating that unless the party served applies to stay the arbitration within ten days after such service he shall thereafter be precluded from objecting that a valid agreement was not made or has not been complied with and from asserting in court the bar of a limitation of time. Such notice shall be served in the same manner as a summons or by registered or certified mail, return receipt requested. An application to stay arbitration must be made by the party served within ten days after service upon him of the notice or he shall be so precluded. Notice of such application shall be served in the same manner as a summons or by registered or certified mail, return receipt requested.

Statement of the Case

Petitioner, Prima Paint Corporation, a Maryland corporation (hereinafter referred to as "Prima"), instituted an action in the United States District Court for the Southern District of New York on November 12, 1965 seeking to rescind a contract of employment dated October 7, 1964, containing an arbitration clause, alleging that the defendant-respondent, Flood & Conklin Mfg. Co. (hereinafter referred to as "F & C"), a New Jersey corporation, had falsely and fraudulently induced Prima, the plaintiff, to accelerate the closing date thereof and execute same (R. 18-21).

F & C agreed to serve Prima "in an advisory and consultative capacity", for a six year period ending October 7, 1970 to the extent Prima might reasonably require. The specified employment, obviously managerial in nature was to be rendered by a particular individual; further F & C agreed not to compete with Prima and to turn over certain customer lists. Prima agreed to make payments to F & C, based upon its sales to said customers, commencing Sept. 1, 1965. The agreement contained provisions defining defaults to consist of Prima's insolvency, an attachment or levy upon the customer accounts, etc., or failure to pay, and upon the occurrence of any one condition, the customer accounts would "automatically revert at once to F & C" without any requirement on the part of F & C to repay or return any portion of payments received from Prima (R. 21-27). The said agreement contained an arbitration clause as follows:

> "8. *Arbitration.* Any controversy or claim arising out of or relating to this Agreement, or the breach

thereof, shall be settled by arbitration in the City of New York, in accordance with the rules then obtaining of the American Arbitration Association, by three arbitrators, one of whom shall be an attorney-at-law and one of whom shall be a certified public accountant, and judgment upon the award rendered may be entered in any Court having jurisdiction thereof. The costs of arbitration shall be shared equally by Prima & F&C."

The jurisdiction of the court below was founded solely on diversity of citizenship and amount (R. 18).

Petitioner alleged that respondent, knowingly, falsely and fraudulently represented that it was a solvent corporation whereas, seven days after execution of the said agreement, and on October 14, 1964, respondent, F & C, filed a voluntary petition under Chapter XI of the Bankruptcy Act and a Receiver of its property was appointed. Upon confirmation of its arrangement proceedings, by order dated March 16, 1965, respondent was revested with title to its property and the instant litigation ensued.

Prima made the first payment as required by the agreement to an escrowee under protest. In its letter of transmittal dated September 17, 1965, Prima alleged various "breaches" of the agreement by F & C, primarily asserting fraud in inducing the said agreement (R. 28-30).

Thereafter, on October 25, 1965, F & C served a Notice of Intention to Arbitrate on Prima pursuant to Section 7503 (c) of the Civil Practice Law and Rules of the State of New York (R. 31-32). The substantive effect thereof, under New York law, would have been to preclude Prima

from objecting that a valid agreement was not made unless Prima applied to a court to stay arbitration.

On November 12, 1965, Prima timely instituted a federal action *solely* seeking to rescind the agreement on the grounds of fraud in the inducement and contemporaneously sought to stay arbitration pending a disposition of its rescission action (R. 11-13). Prima alleged that F & C had represented that it was in all respects a solvent corporation, able to perform the terms and conditions of the agreement, whereas during the time of the negotiations, and even on the threshold of its execution, F & C knew or had reasonable cause to know that it was insolvent and in fact was preparing to immediately file a petition in bankruptcy. That, as a result, Prima was deprived of F & C's services, and suffered substantial diminution in value of F & C trade names, labels, customer accounts, and goodwill conveyed to Prima (R. 40-41).

F & C simultaneously cross-moved pursuant to the provisions of the Federal Arbitration Act, 9 U.S.C. §1 *et seq.* to stay the federal rescission action instituted by Prima and compel arbitration (R. 8-11).

Relying on the precedent of *Robert Lawrence, infra,* the District Court, disposing of both motions, ruled (1) that no fraud is specifically alleged with regard to the arbitration provision; (2) that the said clause is sufficiently broad to cover a dispute over fraudulent inducement, and accordingly, denied Prima's motion to stay arbitration, granted F & C's motion to stay the rescission action, and directed the parties to proceed with arbitration (R. 8-11).

An appeal was timely taken to the Court of Appeals (R. 5) but prior to the time within which the record, briefs and appendices were to be filed, the respondent moved to dismiss the appeal as frivolous (R. 1). Upon oral argument of the motion, the court, at its own request and with the consent of counsel, agreed to hear and determine the appeal on its merits, resulting in an opinion and order dismissing the appeal (R. 45-50).

The Court of Appeals, going further than the District Court, found that the action is a diversity action; that the contract evidences a transaction involving interstate commerce; that the arbitration agreement is separable from the contract within which it is contained and where there is no allegation of fraud in the inducement to enter into the agreement to arbitrate, the issue of fraud as to any other portion of the agreement is properly the province of the arbitrators and not the court.

POINT I

Whether a contract wherein and whereby one of the parties is employed to serve in an advisory and consultative capacity constitutes a contract evidencing a transaction involving interstate commerce.

An Act of Congress is not to be interpreted as superseding all state law dealing with some phase of interstate commerce unless such intent is manifest by the language of the act and the scope which Congress meant it to have for the accomplishment of its apparent aim. *Cloverleaf Butter Co.* v. *Patterson,* 315 U.S. 148, 62 S.Ct. 491, 86

L.Ed. 754 (1942); *Cities Service Gas Co.* v. *Peerless Oil & Gas Co.*, 340 U.S. 179, 71 S.Ct. 215, 95 L.Ed. 190 (1950). Moreover, resort by the courts to the commerce clause cannot defy standards of due process. *Sec'y of Agriculture* v. *Central Roig Ref. Co.*, 338 U.S. 604, 70 S.Ct. 403, 94 L.Ed. 381 (1950).

The purpose of the commerce clause is to protect commercial intercourse from invidious restraint, to prevent interference through conflicting or hostile state laws, and to insure uniformity in regulation (11 Am. Jur., Commerce, §2). However, it is no longer open to question that the formation of a contract between persons in different states is not within the protection of the commerce clause unless the *performance* thereof is within its protection. *Western Live Stock* v. *Bureau of Revenue*, 303 U.S. 250, 58 S.Ct. 546, 82 L.Ed. 823 (1938).

The agreement herein employed F & C to work for Prima for a six year period. If the agreement had been carried into effect, Jerome K. Jelin, Chairman of F & C, would have been required to perform the services of employment on behalf of F & C. Only his out-of-pocket expenses would have been reimbursed by Prima.

These facts do not make this a contract evidencing a transaction in interstate commerce. *San Carlo Opera Co.* v. *Conley*, 72 F.Supp. 825 (S.D.N.Y. 1946), *aff'd*, 163 F.2d 310 (2d Cir. 1947). Any travel in connection with the agreement is a mere incident, not the essential thing. That to which it is incident—the advice and consultation—would not be called trade or commerce in the commonly accepted use of these words. Personal effort, not related to production,

is not a subject of commerce. That which is in its consummation, not commerce, does not become commerce among the states because transportation takes place. *Federal Baseball Club* v. *National League,* 259 U.S. 200 (1922); *Hart* v. *B. F. Keith Vaudeville Exchange,* 12 F.2d 341 (2d Cir. 1926), *cert. denied,* 273 U.S. 704 (1926).

In the *Bernhardt* case, *infra,* the employee was a plant superintendent earning $15,000.00 a year with managerial duties fundamentally those different from workers. It is apparent from this agreement that F & C, through Jerome K. Jelin, would be rendering what would amount to personal and managerial duties which would be fundamentally different than those of workers.

The significant question, therefore, is not whether, in carrying out the terms of the contract, the parties *did* cross state lines, but whether, at the time they entered into it and accepted the arbitration clause, they contemplated substantial interstate activity. Cogent evidence regarding their state of mind at the time would be the terms of the contract and if it, on its face, evidences interstate traffic, such as did the shipment from New York to Massachusetts in the *Lawrence* case, cited *infra,* the contract would come within Section 2. In addition, evidence how the parties expected the contract to be performed and how it was performed is relevant to whether substantial interstate activity was contemplated. *Metro Industrial Painting Corp.* v. *Terminal Construction Corp.,* 287 F.2d 382, 387 (2d Cir. 1961), *cert. denied,* 368 U.S. 817, 82 S.Ct. 31 (1961).

> "the fact that it is necessary for one party to cross state lines in order to fulfill obligations arising out of the contract should not by itself bring the arbi-

> tration clause within the reach of the Federal Statute . . ." (*Metro Industrial Painting Corp.* v. *Terminal Const. Corp., supra,* p. 388.)

Like the *San Carlo Opera* case, *supra,* the agreement involved herein was one for personal employment and specified the particular person who would render said employment.

This contract does not evidence a transaction in interstate commerce but is merely an agreement for personal or managerial services; as such, the Federal Arbitration Act is inapplicable and the court below erred in not applying state law to determine the issues raised and the rights of the litigants.

POINT II

Where jurisdiction exists solely by virtue of diversity of citizenship, the Federal Arbitration Act requires the validity of an arbitration agreement contained in a contract evidencing a transaction in interstate commerce to be determined in accordance with applicable state created rights.

The Court of Appeals for the Second Circuit reaffirmed the unique precedent originally established by it in the case of *Robert Lawrence Co.* v. *Devonshire Fabrics, Inc.,* 271 F.2d 402 (2d Cir. 1959), *cert. granted,* 362 U.S. 909 (1960), *dismissed pursuant to Rule 60,* 364 U.S. 801 (1960), holding that:

> "The Arbitration Act in making agreements to arbitrate 'valid, irrevocable, and enforceable' *created national substantive law clearly* constitutional under the maritime and commerce powers of the Congress

> and that the rights thus created are to be adjudicated by the Federal Courts whenever such courts have subject matter jurisdiction, *including diversity cases . . .*"[1]

The court concluded that this "national substantive law" (if there be such) requires, even where jurisdiction is based solely on diversity of the parties, that an arbitration agreement be separable from the contract within which it is contained, and notwithstanding contrary state law, where there is no allegation of fraud in the inducement to enter into the agreement to arbitrate, the resolution of whether there was in fact fraud in the inducement of the contract containing the arbitration agreement is properly within the province of the arbitrators and not the court.

This result is in direct conflict with the holdings of the 9th Circuit in *Ross* v. *Twentieth Century-Fox Film Corp.*, 236 F.2d 632 (1956); the 6th Circuit in *American Airlines, Inc.* v. *Louisville & Jefferson County Air Board,* 269 F.2d 811 (1959), and, further contradicts the stated position of the 1st Circuit, indicated by *dicta* in *Lummus Co.* v. *Commonwealth Oil Refining Co.,* 280 F.2d 915 (1960), *rehearing denied,* 280 F.2d 932 (1960), *cert. denied,* 364 U.S. 911 (1960). In effect, the 2d Circuit directly overruled its own earlier decision in *Kulukundis Shipping Co.* v. *Amtorg Trading Corp.,* 126 F.2d 978 (2d Cir. 1942).

In order to establish this unique precedent, the Second Circuit admittedly disagreed with an eminent Associate Justice of this court[2]; and then, without any basis in fact

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[1] 271 F. 2d 402, 409; R.50 (Additional emphasis supplied).

[2] *Robert Lawrence* v. *Devonshire Fabrics, Inc.,* 271 F. 2d 402, 404.

or in law, misconstrued Congressional intent and created a legal fiction of separability of the arbitration clause from the contract within which it is contained, in order to avoid accepted constitutional limitations enunciated by this court in *Erie R. Co.* v. *Tompkins,* 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188, 114 A.L.R. 1487 (1938); *Guaranty Trust Co.* v. *York,* 326 U.S. 99, 65 S.Ct. 1464, 89 L.Ed. 2079, 160 A.L.R. 1231 (1945); and *Bernhardt* v. *Polygraphic Co. of America, Inc.,* 350 U.S. 198, 76 S.Ct. 273, 100 L.Ed. 199 (1956).

A. The United States Arbitration Act does no more, nor was it intended by Congress to do more, than regulate the manner in which federal courts are to enforce state created rights in diversity cases.

This court, in *Bernhardt* v. *Polygraphic Co. of America, Inc., supra,* reversed an attempted interpretation by 2d Circuit of §3 of the Arbitration Act, which had construed the same to liberally apply and affect *all contracts,* regardless of subject matter, holding that "§§1, 2, and 3 are integral parts of a whole . . . §§1 and 2 define the field in which Congress was legislating."[3]

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[3] Compare, *U. S.* v. *Electronic & Missile Facilities, Inc.,* 364 F. 2d 705, (2d Cir. 1966) where the 2d Circuit recently stayed the suit of a subcontractor commenced under The Miller Act on the ground that the subcontract provided for arbitration of all disputes; holding that the Arbitration Act is broad enough to include Miller Act suits within its scope and distinguishing *Wilko* v. *Swan,* 346 U. S. 427, 74 S.Ct. 182, (1953) and *Bernhardt* v. *Polygraphic Co. of America, Inc., supra.* Although the jurisdiction was invoked on grounds other than diversity of the parties, the court, nevertheless, construed § 3 as applying, specifically disregarding whether the contract was within § 2. *The court then applied state substantive law to determine validity of the arbitration clause.*

Having found that §2 is definitional in scope in *Bernhardt, supra,* the constitutional question avoided therein, but presented in the instant case, compels the conclusion, in the light of *Erie* and *York,* that the Arbitration Act merely regulates the manner in which federal courts are to enforce state created rights in diversity cases.

In *Shanferoke Coal & Supply Corp.* v. *Westchester Service Corp.,* 293 U.S. 449, 55 S.Ct. 313, 79 L.Ed. 583 (1935), a pre-*Erie* case, the Arbitration Act was applied in a diversity case, involving interstate commerce, however, the majority in *Bernhardt* v. *Polygraphic Co., supra,* pointedly indicated that *Shanferoke's* application to a diversity case might be decided differently today. By thus inferentially overruling *Shanferoke,* this court demonstrated its intention to apply the *Bernhardt* doctrine equally to all diversity cases, inclusive of contracts involving interstate commerce.

The majority opinion intimates, and Mr. Justice Frankfurter's concurrence explicitly states:

> "Since the United States Arbitration Act of 1925 does not apply to diversity cases, in the light of its terms and relevant interpretive materials, avoidance of the constitutional question is for me sufficiently compelling to lead to a construction of the Act as not applicable to diversity cases."[4]

B. The Act's language, scope and background conclusively support a construction that §2 is purely remedial in character when applied to a diversity situation.

Except for §§1 and 2, all the other sections of the Act deal solely with enforcement. Is it manifestly clear from

[4] 350 U. S. 198, 208 (1956).

its legislative history (Cong. Rec. pg. 1931, 68 Cong. 1st Sess. (1924); H.R. Rep. No. 96, 68 Cong., 1st Sess. (1924); S. Rep. No. 536, 68 Cong. 1st Sess. (1924)), that Congress in enacting this statute sought and intended to provide the federal courts solely with procedural machinery or a regulatory scheme with which to enforce arbitration agreements.[5] It intended to grant "no new rights, except a remedy to enforce an agreement." (Cong. Rec. pg. 1931, 68 Cong. 1st Sess. (1924).

The statute was enacted into law by Congress on February 12, 1925, a year after this court's decision in *Red Cross Line* v. *Atlantic Fruit Co.*, 264 U.S. 109, 44 S.Ct. 274, 68 L.Ed. 582 (1924), declaring such an agreement valid. Therefore, Congress was not creating rights where none had heretofore existed, *but was merely affording a procedure for the enforcement of then existing rights.*

The Senate Committee referred[6] to *Red Cross Line* v. *Atlantic Fruit Co., supra,* in which arbitration was characterized as relating to remedy. Despite criticism of the case for its characterization of arbitration,[7] Congress' reliance on it demonstrates its intention and understanding that the

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[5] The Report of the House Committee stated in part: "Arbitration agreements are purely matters of contract, and the effect of the Bill is simply to make the contracting party live up to his agreement. He can no longer refuse to perform his contract when it becomes disadvantageous to him. An arbitration agreement is placed upon the same footing as other contracts, where it belongs . . . The Bill declares simply that such agreements for arbitration shall be enforced, and provides a procedure in the Federal courts for their enforcement."

[6] S.Rep. No. 536, 68 Cong., 1st Sess. 3 (1924).

[7] Kochery, The Enforcement of Arbitration Agreements in the Federal courts: *Erie* v. *Tompkins,* 39 Cornell L. Q. 74, 83 (1953).

Arbitration Act was to regulate procedure in the federal courts.

Moreover, it is significant that the Arbitration Act was patterned upon the New York statute (N. Y. Sess. Laws 1920, ch. 275 (now N.Y.C.P.L.R., §7501 *et seq.*) which had been passed five years earlier and held constitutional by New York's highest court (*Berkowitz* v. *Arbib & Houlberg, Inc.*, 230 N.Y. 261, 130 N.E. 288 (1921), on the ground that arbitration is part of the law of remedies. See *Meacham* v. *Jamestown F. & L. R.R.*, 211 N.Y. 346, 105 N.E. 653 (1914).

The only proper construction to be accorded §2 by this court, where jurisdiction is founded upon diversity of citizenship, was suggested by Mr. Justice Frankfurter in his *Bernhardt* concurrence; that the Arbitration Act, and the institution of proceedings under it, cannot create rights, but can only provide a *means* for adjudicating the parties' underlying dispute founded upon state created rights.[8]

That Congress intended §2 to be remedial in its scope is evident from the complete absence of any expressed Congressional intent to make the Arbitration Act applicable to state court actions, and the view of contemporary writers that such effect was not intended.[9]

Further support for this proposition is found in the *Robert Lawrence* case itself, where in *dicta*, Judge Medina noted that:

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[8] 350 U.S. 198, 207-9 (1956).

[9] Cohen & Dayton, The New Federal Arbitration Law, 12 Va. L.Rev. 266,277 (1926); 20 Ill. L.Rev. 111 (1925); 11 A.B.A.J. 153,155 (1925).

"... suits involving the application of the Arbitration Act do not furnish an independent basis of federal jurisdiction under 28 U. S. C. §1331."[10]

If §2 is construed as conferring federal rights only when the *fortuity* of diversity of citizenship or other grounds of jurisdiction exist, but not otherwise, it would then raise serious collateral constitutional questions concerning denial of equal protection of the law and due process of law, and would further result in binding the state courts in a manner obviously not intended by Congress when it enacted the Arbitration Act. Such an interpretation would conflict with constitutional limitations and precedent established by the *Erie* and *York* cases; only serve to resurrect the spectre of *Swift* v. *Tyson*, 41 U.S. (16 Pet.) 1, 10 L.Ed. 865 (1842), making the rights of litigants vary according to whether enforcement was sought in the state or in the federal courts; encourage forum shopping,[11] and subject parties to prelitigative uncertainty of obligation.

POINT III

Construing the Arbitration Act as creating federal substantive law, an arbitration clause in a contract does not exist as a separable, special agreement.

A. Doctrine of Separability

This court has recognized that ordinary commercial arbitration agreements are founded on axiomatic contract prin-

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[10] 271 F.2d 402, 408 (1959).

[11] 24 N.Y. County Lawyers Assoc. Bar Bul. 17, (1967), wherein the resulting difference in outcome based on selection of the courthouse was emphasized.

ciples and function differently from disputes involving a national interest protected by intended Congressional enactment. *Atkinson* v. *Sinclair Refining Co.*, 370 U.S. 243, 82 S.Ct. 1318 (1962). Grievances arising from commercial contracts made between private citizens are not steeped in strong national interest or policy, such as instances where industrial strife occurs, as represented by the National Labor Act cases [12] requiring federal courts to make common law under the provisions of §301 of the Taft Hartley Act (61 Stat. 156 (1947); 29 U.S.C. §185 (1958).

Even in these instances, this court has always recognized that the making of such an agreement is a justiciable question;

> "To be sure, since arbitration is a creature of contract, a court must always inquire, when a party seeks to invoke its aid to force a reluctant party to the arbitration table, whether the parties have agreed to arbitrate the particular dispute. In this case, the question of whether a dispute is 'arbitrable' is inescapably for the court." (Separate opinion of Brennan, J.; Harlan, J., concurring *United Steelworkers of America* v. *American Manufacturing Co., etc.*, 363 U. S. 570).

In the area covered by the Arbitration Act, less of a problem is given to the judiciary, than that of appreciating institutional difficulties and fashioning a body of law such

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[12] *Textile Workers* v. *Lincoln Mills*, 353 U.S. 448, 77 S.Ct. 912, 1 L.Ed.2d 973 (1957); *United Steelworkers* v. *American Manufacturing Co.*, 363 U.S. 564, 80 S.Ct. 1343, 4 L.Ed.2d 1403 (1960); *United Steelworkers* v. *Warrior & Gulf Nav. Co.*, 363 U.S. 574, 578, 80 S.Ct. 1347; 4 L.Ed.2d 1409 (1960).

as occurs in the labor-management field, since the issues presented for judicial consideration in ordinary commercial agreements will be narrower, and there will be no need to consider the complexities peculiar to collective-bargaining agreements.

In *Moseley* v. *Electronic & Missile Facilities, Inc.*, 347 U.S. 167, 172, 83 S.Ct. 1815, 10 L.Ed.2d 818 (1963), the Chief Justice and Mr. Justice Black, concurring, established their position on the precise issue herein presented, in stating:

> "We agree with the court that fraud in the procurement of an arbitration contract, *like fraud in the procurement of any contract, makes it void and unenforceable and that this question of fraud is a judicial one,* which must be determined by the court. To allow this question to be decided by arbitrators would be to that extent to enforce the arbitration agreement, even though steeped in the grossest kind of fraud". (Emphasis supplied.)

It has been recently suggested by this court, *Drake Bakeries, Inc.* v. *Local 50, American Bakery,* 370 U.S. 255, 261, 80 S.Ct. 1346 (1962), that arbitration clauses and no-strike clauses do not justify either party to the contract in wrenching them from their context, on the ground that they are mutually dependent covenants *which are separate from the other promises between the parties,* and that the issue of arbitrability is a question for the courts and is to be determined by the contract entered into by the parties.[13] The court noted, unlike the case at bar, that the petitioner

[13] 370 U.S. 261, n.7.

had not attempted or claimed the right, either to *terminate the entire contract* or extinguish permanently its obligations thereunder.

B. Proper Law to Apply

Assuming the intention of Congress in §2 was to furnish the right to have agreements to settle disputes by arbitration treated no differently from other contracts, the said right would be properly protected by applying state law to decide a dispute over the making or the validity of the contract.

The Congressional purpose was the more limited one of removing outmoded judicial hostility to the specific enforcement of an arbitration agreement before an award. The use of the word "valid" should be regarded as merely restating the pre-existing law that an arbitration award was judicially enforceable, and that even if an arbitration agreement was not specifically enforceable, nominal damages could be recovered for its breach.[14]

Such a construction is justifiable because Congress did not displace the underlying state-created rights on the contract. Thus, the question whether an arbitration clause is separable, and whether any contract exists, refers to the same body of law under which all other rights except enforceability of the arbitration clause are determined. The considerations favoring the application of state law apply with particular force with respect to the question of the interpretation of an arbitration clause, since the statute

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[14] H.R.Rep. No. 96, *supra;* S.Rep. No. 536 *supra;* 66 Cong.Rec. 984 (1925).

makes no mention of interpretation. Furthermore, New York courts do not appear to have found any inconsistency between the legislative policy of their state in favor of arbitration, embodied in a statute on which the federal act was based, and the doctrine that the issue raised by a general allegation of fraud in the inducement is not referable to arbitration.[15]

In the final analysis, the contracting parties can easily avoid the danger of hostility toward arbitration manifested in restrictive state-court decisions interpreting an arbitration clause, and obviate same by the use of sufficiently explicit language.

Arbitration would be protected and Congress' intention effectuated without requiring federal judges to fashion, in the absence of any Congressional guidance, a federal common law upon such issues as fraud, duress and mistake, which would result in abrogating and displacing well developed state rules.

The ambiguity and uncertainty of the *separability doctrine* spawned by the 2d Circuit in the *Robert Lawrence* case, *supra*, is amply demonstrated in *El Hoss Engineering* v. *Amer. Ind. Oil*, 289 F.2d 346 (2d Cir. 1961), in which the same court reversed a lower court applying "separability"

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[15] Matter of *Wrap-Vertiser Corp.* (*Plotnick*), 3 N.Y.2d 17, 143 N.E.2d 366; *Manufacturers Chemical Co.* v. *Caswell*, 259 A.D. 321, 19 N.Y.S.2d 171 (1st Dept. 1940), appeal dismissed, 283 N.Y. 679, 28 N.E.2d 404; *Cheney Bros.* v. *Joroco Dresses, Inc.*, 218 A.D. 652, 219 N.Y.S. 96 (1st Dept. 1926), reversed on other grounds, 245 N.Y. 377, 157 N.E. 272; *Reo Garment, Inc.* v. *Jason Corp.*, 9 Misc. 2d 521, 170 N.Y.S.2d 412 (1958); *Greenspan* v. *Greenspan*, 129 N.Y.S.2d 258 (1954); *Exercycle Corp. & Maratta*, 9 N.Y.2d 329, 174 N.E.2d 463 (1961).

as "erroneous". The court concerned itself with first ascertaining the *intent* of the parties from an examination of the entire instrument using the traditional approach of common law judges when questions involving the validity or interpretation of contract are presented.[16] The court held, the intent of the parties was that the arbitration agreement and the enforcement thereof, was conditioned upon the plaintiff's prior performance of certain other terms of the contract, thus resulting in an obstacle to the separability doctrine.

In order to reconcile these holdings, one can only conclude, that the intention of the parties to the contract, applying common law principles is paramount. In the instant case, petitioner contends by its action for rescission, that its intention was fraudulently induced, thereby preliminarily requiring a justiciable determination.

Thus, issues involving the "making" or "validity" of the arbitration agreement, which the Federal Act declares are issues for the Court (see 9 U.S.C. Section 3 and 4), should be decided under state rules of "law and equity". Among such issues would be fraud, duress, mistake and, as held in *American Air Lines Inc.* v. *Louisville & Jefferson County Board, supra,* lack of legal capacity to agree to arbitrate.

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[16] 289 F.2d 346, 349.

POINT IV

Construing the Arbitration Act as creating federal substantive law, an arbitration clause covering "any controversy or claim arising out of or relating to this agreement, or the breach thereof", requires the question of whether the contract containing such arbitration clause has been fraudulently induced, to be in the first instance determined judicially.

A. Equitable rescission for fraud prevents arbitration.

We submit that the Second Circuit erred in its ruling with regard to rescission when it held:

> "... though the recovery sought ... may differ, the ground upon which each recovery is sought, is that of the alleged fraudulent inducement, an issue we hold is one for the arbitrators to resolve" (R. 49).

The Court, when it disregarded the distinction between an action in equity for rescission as opposed to an action at law for damages for fraud, destroyed the petitioner's inherent right to elect its remedy. The ruling ignores the substantive difference between an action at law, which is an affirmance of contract, as contra-distinguished with an action in equity, which is a disaffirmance thereof.

It was well settled at common law that an aggrieved party had a right to relief by way of rescission whenever he had been induced to enter into a contract by either an innocent or fraudulent misrepresentation.[17]

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[17] *Cochran* v. *Cummings*, 4 U.S. 250, 4 Dall. 250, 1 L.Ed. 820 (1802).

> "It is a general rule that a party who has been induced to enter into any contract, obligation, or engagement by means of fraud, deceit, artifice or trickery practiced upon him by the opposite party, and who would not have placed himself in the situation in which he now is, if it had not been for the fraud or deceit, will be entitled to rescind the contract and demand a restoration of the status quo, and have the aid of a court of equity to accomplish this purpose. Fraud is in fact one of the broadest grounds giving jurisdiction to a court of equity, and, when frauds exists, the aggrieved party is not bound to resort to another tribunal, possessed of less power and of less perfect remedies to ascertain the truth and grant relief, although another tribunal, such as a court of law, may also have jurisdiction" (1 *Black on Rescission and Cancellation,* 2d Ed., 24-25).

The doctrine of "clean hands" is essential to equitable relief, therefore the election to rescind is peculiar to the defrauded party.[18] To permit the malfeasor to raise any portion of the document as a barrier to equitable relief would give countenance to the fraud and benefit the perpetrator.[19]

> "It is the peculiar province of equity to relieve against every species of fraud. 'Parties should not be permitted to obtain an unjust advantage over others by trickery . . . 'If a case of fraud be established, a court of equity will set aside all transac-

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[18] 2 Restatement of Contracts §476 (1) (1932).

[19] See also, *Carrington* v. *Pratt,* 59 U.S. 63 (1855); *Scarborough* v. *Atlantic Coast Line R. Co.,* 178 F.2d 253, 258 (4th Cir. 1949), *cert. denied,* 339 U.S. 919, 70 S.Ct. 621, 94 L.Ed. 1343 (1950).

> tions founded upon it by whatever machinery they have been effected, and notwithstanding any contrivance by which it may have been attempted to protect them' . . . ". (*Kansas City Southern Ry. Co.* v. *May*, 2 F.2d 680, 687, 8th Cir. 1924).

For the court below to have arbitrarily disregarded the foregoing distinction deprived the petitioner of his substantive rights.

B. An arbitration clause must be dependent.

The determinative test of separability, as enunciated by this court in *United States* v. *Bethlehem Steel Corp.*, 315 U.S. 289, 298, 62 S. Ct. 581, 587 (1942), is:

> ". . . the Courts below, however, treated these clauses as non-separable. To do otherwise would call for departure from accepted principles of the law of contract. Whether a number of promises constitute one contract or more than one is to be determined by inquiring 'whether the parties assented to all the promises as a single whole so that there would have been no bargain whatever if any promise or set of promises were struck out.' *Williston on Contracts*, Rev. Ed. Sec. 863, and cases therein cited."

Assent to arbitration is founded upon the assumption that the underlying transaction is honest, genuine and being candidly consummated. Thus, it is a ridiculous conclusion to believe that men consciously and separably would agree to arbitrate any fraud that would give rise to an action to set aside their agreement.

"A transaction voidable for fraud or misrepresentation cannot be avoided in part . . ."[20]

Applying the traditional approach of common law judges and the precedents of this court, federal substantive law declares that the arbitration clause cannot be severed. It is utterly dependent upon the existence of a subject, and were we to delete this subject leaving only the arbitration clause, there could never have been a bargain, much less a contract evidencing a transaction in interstate commerce. The parties did not consent to arbitration in a vacuum and to say that the parties contemplated fraud is specious.

Furthermore, since arbitration in essence is a waiver of judicial control, due process requires an interpretation that the threshold question of whether the party has in fact agreed to arbitrate and thereby waive judicial rights be justiciably determined.

CONCLUSION

That for the reasons stated, it is respectfully submitted that the judgment of the Court below be reversed.

Dated: New York, N. Y.
January 25, 1967

Robert P. Herzog,
Attorney for Petitioner,
Prima Paint Corporation.

Of Counsel:

Jules Teitelbaum,
Grace L. Brodsky.

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[20] 2 Restatement of Contracts, §487 (1932); 6A *Corbin on Contracts*, §1444.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

No. 343

PRIMA PAINT CORPORATION,
Petitioner,

v.

FLOOD & CONKLIN MFG. CO.,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENT

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

No. 343

PRIMA PAINT CORPORATION,

Petitioner,

v.

FLOOD & CONKLIN MFG. CO.,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENT

Respondent adopts petitioner's statement of "Opinions Below" and "Jurisdiction."

Questions Presented

1. Whether the United States Arbitration Act requires that the interpretation and effect of an arbitration agreement contained in a contract involving interstate commerce be decided under federal law rather than state law.

2. Whether, under federal law, an agreement to arbitrate "any controversy or claim arising out of or relating to this agreement, or the breach thereof" requires an arbitrator rather than a court to hear and determine the issue of fraud in the inception of the contract when the

charge of fraud is not directed to the arbitration agreement which is contained in the contract.

3. Whether a party seeking to stay an arbitration proceeding on the ground that the contract containing the arbitration agreement was induced by fraud must, in any event, show the court upon the application for a stay that there is substance to the allegation of fraud.

Statement

On October 7, 1964, the parties entered into a written agreement (R. 21) (the "Agreement"), whereunder respondent, Flood & Conklin Mfg. Co. ("F & C"), turned over to petitioner, Prima Paint Corporation ("Prima"), two lists (referred to at paragraph 4(a) of the Agreement as Exhibits "A" and "B", R. 22) bearing the names of F & C's customers for paint and related products. F & C covenanted that it would no longer make any sales of paint or paint products to any of such customers or to anyone else within the territory in which it had made sales during the past year (Para. 3, R. 22). In addition, F & C agreed to render (through Mr. Jerome K. Jelin, its Chairman, except in the event of his death or disability) such advisory and consultative services as Prima might reasonably require in connection with its formulae and manufacturing operations, as well as in respect of sales and servicing of Prima accounts (Para. 2, R. 22).

In return for the immediate disclosure by F & C of its customer lists, for its covenant not to compete, and for its agreement to render advisory and consultative services, as aforesaid, F & C was to be paid a stated percentage of Prima's receipts, over the next six years, from prior customers of F & C and from customers for F & C's products, as defined in the Agreement (Para. 4, R. 22).

The first payment to be made to F & C by Prima was not due until September 1, 1965, the first day of the eleventh month after the effective date of the Agreement (Para. 4(c), R. 23). While the Agreement provides that Prima's total obligation to F & C is not to exceed $225,000 over the six year period (Para. 4(g), R. 24), no minimum amount is guaranteed to F & C; its compensation is entirely dependent on the volume of future sales made by Prima to prior customers of F & C.

Although Paragraph 7 of the Agreement (R. 25) deals at length with the consequences of Prima's becoming bankrupt or otherwise becoming unable to make required payments during the six year term, the Agreement contains no provision relating either to the solvency or to any subsequent insolvency of F & C.

One week after the Agreement was entered into, F & C filed a voluntary petition in the United States District Court for the District of New Jersey under the provisions of Chapter XI of the Bankruptcy Act. As is evident from an affidavit submitted in the instant action by Prima's president, Prima was aware of this filing and of the subsequent progress of the Chapter XI proceeding. He there states the claimed effect such proceedings had upon Prima and upon the benefits Prima had sought to derive from the Agreement (R. 39, 40-41). He terms the result "chaos and havoc (R. 41)."

Notwithstanding the foregoing, Prima in fact made no complaint to F & C or to any of its representatives during the pendency of the Chapter XI proceeding. Rather, Prima continued to exploit the customer lists and the other assets which it had acquired from F & C and to avail itself of such advisory and consultative services as it desired without a hint of any grievance. Thereafter, on March 16,

1965, only five months after the Chapter XI proceeding had been instituted, F & C's Amended Plan of Arrangement with its creditors was confirmed by the Referee in Bankruptcy (R. 34); the Chapter XI proceeding thereby ended and F & C was revested with its assets.

During the ensuing six months Prima continued, without complaint, its use of F & C's consulting services and customer lists. Only on September 17, 1965, when the initial payment to F & C was seventeen days past due, did Prima complain. In a letter to F & C's attorneys, it set forth a series of ten claimed "breaches" on the part of F & C (R. 28), asserting that "Flood & Conklin Mfg. Co. is presently indebted to Prima Paint Corporation for failure to comply with the various provisions of the above described Consulting Agreement * * *" (R. 28), and it deposited the payment then due in escrow in accordance with the provisions of Paragraph 7(v) of the Agreement.

On October 25, 1965, it having by then become apparent that the controversy created by Prima's letter of September 17, 1965 could not be amicably resolved, F & C served Prima with a Demand for Arbitration (R. 31) under the rules of the American Arbitration Association. The commencement of arbitration proceedings was in accordance with the agreement of the parties that

> "Any controversy or claim arising out of or relating to this Agreement, or the breach thereof, shall be settled by arbitration in the City of New York, in accordance with the rules then obtaining of the American Arbitration Association, by three arbitrators, one of whom shall be an attorney-at-law and one of whom shall be a certified public accountant, and judgment upon the award rendered may be entered in any Court having jurisdiction thereof. The costs of arbitration shall be shared equally by Prima and F & C (Para. 8, R. 26)."

By stipulation dated November 2, 1965, F & C extended Prima's time to answer the Demand for Arbitration until November 15, 1965 (R. 33).*

Thereafter, on November 12, 1965, Prima instituted an action against F & C in the United States District Court for the Southern District of New York (R. 18). The complaint alleged jurisdiction on the basis of diversity of citizenship (Prima being alleged to be a Maryland corporation having its place of business in Maryland, and F & C a New Jersey corporation having its principal place of business outside of Maryland), and that the matter in controversy exceeded ten thousand dollars.

Although Prima had claimed ten separate "breaches" in its letter of September 17, 1965 (R. 28), its complaint neither seeks nor alleges any damages, but asks only for a judgment that the Agreement be rescinded (R. 20). The sole ground upon which Prima relies in seeking rescission is that F & C had "fraudulently induced" Prima "to accelerate the execution and closing date of the said agreement herein, from October 21, 1964 to October 7, 1964 (Complaint, para. SIXTH, R. 19)." The fraud charged revolves about the allegation that F & C "represented and stated to Prima that F & C was in all respects a solvent corporation and able to perform all of the terms and conditions of the said agreement on its part to be performed (Complaint, para. SEVENTH, R. 19)." Prima then alleges that it would not have entered into the Agreement but for the "false and fraudulent" statements made by F & C (Complaint, para. TWELFTH, R. 20). The complaint does not allege, however, nor does the Record anywhere indicate,

* Under Section 7 of the Commercial Arbitration Rules of the American Arbitration Association, Prima's time to answer would have otherwise expired seven days after service of the Demand, in which event, if no answer were filed, the claim would have been deemed denied.

that F & C's Chapter XI proceeding in any way prevented F & C from performing any of its undertakings or prevented Prima from obtaining the benefits of its bargain.

No charge is made by Prima that the agreement of the parties to arbitrate disputes, referred to above, was fraudulently induced.

Contemporaneously with the institution of its action, Prima sought a preliminary injunction restraining F & C "from proceeding with arbitration until the question of the validity of the contract, which is the subject matter of the District Court proceedings, can be litigated (R. 12)." Presumably, Prima intends that the controversy concerning the nine other "breaches" claimed in its letter of September 17, 1965 will be resolved by arbitration only if and when Prima loses the trial and subsequent appeal in the action it commenced for rescission.

In none of the papers submitted to the Court by Prima did it attempt to explain how F & C's financial condition was in any way material to the realization by Prima of the benefits contemplated by the Agreement. Prima's reliance, perforce, was on the customer lists, on the agreement of F & C not to compete, and on the availability of Jerome K. Jelin to render consulting services. No charge of fraud is alleged as to any of these matters. Indeed, as asserted in an affidavit submitted in F & C's behalf (R. 17), F & C was asked to and did actually perform its consulting function, and no claim of "fraud" was raised by Prima until a year after the supposed fraud was perpetrated. Prima concedes, in its president's affidavit, that it did not charge F & C with misrepresentation at any time before September 17, 1965 (R. 40).

Nowhere does Prima even attempt to explain why it waited thirteen months after knowledge of F & C's Chapter

XI proceedings before initiating an action seeking rescission on the alleged ground of fraud in the inducement.

Nowhere does Prima explain why it continued to use F & C's customer lists and to avail itself of the consulting services of Mr. Jelin after it became aware of the alleged misrepresentation.

Nowhere does Prima even attempt to discuss how the claimed misrepresentation could have deprived it of the benefit of its bargain in the face of the fact that Prima's sole contractual obligation to F & C is to pay F & C a percentage of future receipts obtained by Prima from F & C's past customers. Prima was obviously not prejudiced, for if it made no sales, it owed F & C nothing.*

In opposition to Prima's motion for an order restraining arbitration F & C cross-moved for an order compelling arbitration and staying the action commenced by Prima (R. 13).

The District Court (Croake, J.), disposing of both motions together, denied Prima's motion to stay arbitration and granted F. & C's motion staying the action pending arbitration (R. 8). In so doing, the court expressly relied upon the precedent established by *Robert Lawrence Company* v. *Devonshire Fabrics, Inc.*, 271 F. 2d 402 (2nd Cir. 1959), *cert. granted* 362 U. S. 909 (1960), *dismissed pursuant to Rule 60*, 364 U. S. 801 (1960).

Prima then appealed to the United States Court of Appeals for the Second Circuit. On F & C's motion (R. 1), that court dismissed the appeal as frivolous, having first reviewed the Agreement and concluded that "Beyond peradventure [it] evidences a transaction involving interstate

* Since Prima has alleged in its complaint that the amount in dispute exceeds ten thousand dollars, it is clear that Prima is in fact making substantial sales to F & C's customers.

commerce (R. 47)." In applying federal law and dismissing the appeal, the court below declined to express any opinion as to the merits of Prima's claim of fraud, for it did not wish to be regarded as "suggesting to the arbitrators the result they should reach (R. 46)." The court below thus reaffirmed its earlier holding in *Robert Lawrence Company* v. *Devonshire Fabrics, Inc.* and concluded by stating that "arbitration should now proceed promptly (R. 50)."

The arbitration proceeding, however, has been held in further abeyance pending the decision of this Court. In the interim, in order to avert acceleration pursuant to clause (v) of paragraph 7 of the Agreement (R. 26), Prima has continued to make payments into escrow of moneys that would otherwise be due to F & C (R. 43). F & C is, however, no nearer to resolution of the controversy created by Prima or to receipt of the funds than it was in October, 1965 when it commenced arbitration proceedings. Thus, by the mere allegation of fraud in the inducement, Prima has already succeeded in frustrating the quick and economical resolution of disputes for which the parties bargained in their arbitration agreement.

Summary of Argument

I

In *Bernhardt* v. *Polygraphic Co.*, 350 U. S. 198 (1956) this Court held that the differences between arbitration and judicial determination of a controversy touched upon substantive rights and that accordingly, a federal court sitting in a diversity case must apply local law rather than the United States Arbitration Act when the arbitration provision before it was contained in a contract not within the scope of Section 2 of the Act. *Bernhardt* did not decide whether Section 2 of the Act created a federal right to arbitration so that diversity cases within its scope could be decided without reference to local law.

The court below, in answering this question affirmatively, followed the precedent established by *Robert Lawrence Company* v. *Devonshire Fabrics, Inc.*, 271 F. 2d 402 (2nd Cir. 1959), *cert. granted* 362 U. S. 909 (1960), *dismissed pursuant to Rule 60*, 364 U. S. 801 (1960). The decision that the United States Arbitration Act was meant to create a new body of substantive law is predicated upon the Congressional exercise of its commerce and admiralty powers in Section 2 of the Act. Had the Act been intended to do no more than promulgate a federal procedure for state-created rights, there would have been no need for Congress to limit the Act, as it did, to arbitration provisions in maritime transactions and in contracts involving interstate or foreign commerce.

In enacting the United States Arbitration Act (9 U.S.C. §§ 1-14) in the year 1925, Congress apparently did not expressly consider its application to actions in state courts; however, the Act was generally assumed to include

all matters before the federal courts including those based upon diversity of citizenship. See Cohen & Dayton, *The New Federal Arbitration Law,* 12 Va. L. Rev. 265, 267 (1926); Note, 69 Yale L. J. 847, 852-856 (1960).

Robert Lawrence accordingly held that the United States Arbitration Act created national law, applicable in state courts as well as federal courts. In so holding, the court made the choice least likely to frustrate the clear intent of a Congress which was obviously not aware of the doctrine to be enunciated thirteen years later in *Erie R. Co.* v. *Tompkins,* 304 U. S. 64 (1938). The consequences of imposing an obligation upon state courts to apply the United States Arbitration Act in cases dealing with arbitration provisions contained in contracts involving interstate or foreign commerce hardly constitutes an encroachment on important state policies of a magnitude sufficient to outweigh the frustration of Congressional intent which would otherwise ensue by deleting all diversity cases from the operation of the Act even though they come within the scope of Section 2.

The notion that the United States Arbitration Act has created federal substantive law has met with resounding favor among the federal judiciary throughout the Nation and should receive the approval of this Court.

II

The interpretation and effect of an arbitration provision within the scope of the United States Arbitration Act should be determined under federal law to be fashioned by the courts in accordance with the policy of the Act. If federal law were to adopt local law in such matters, the result would be frustration of Congressional intent even greater than would flow from a decision that

the Act has no application to diversity cases within the scope of Section 2 of the Act. As seen in *Bernhardt* (where the law of Vermont was involved), there are still states which refuse to enforce agreements to arbitrate future disputes. Thus, reference to state law could result in an emasculation of the Act.

III

There is no public policy which would prevent an agreement to arbitrate all future disputes including a dispute that there had been fraud in the inception of the contract within which the arbitration provision is contained. By applying this approach, the court below properly limited its inquiry to two matters: did the charge of fraud relate to the agreement to arbitrate disputes, and if not, is the particular arbitration provision broad enough to cover the charge of fraud?

The operative language of the arbitration agreement contained in the principal contract is that recommended by the American Arbitration Association. The United States Courts of Appeals for both the First Circuit and the Fifth Circuit, as well as the court below, have held that language to be of such breadth as to compel a finding that the parties intended to arbitrate disputes involving charges of fraud. *Lummus Company* v. *Commonwealth Oil Refining Co.*, 280 F. 2d 915, 931 (1st Cir. 1960), *cert. denied* 364 U. S. 911 (1960); *Electronic & Missle Facilities, Inc.* v. *United States*, 306 F. 2d 554, 555 n.2 (5th Cir. 1962), reversed on other grounds, 374 U. S. 167 (1963). Similar clauses have likewise been held by various state courts to encompass disputes involving fraud.

The fact that Prima's choice of remedy for the alleged fraud is rescission rather than damages should not affect

the arbitrability of the dispute. If the choice of remedy were controlling, a party could have the unilateral, unfettered power, seriously to delay, if not altogether thwart, an arbitration proceeding despite the mandate of Congress that agreements to arbitrate are "valid, irrevocable, and enforceable" (9 U.S.C. §2). As noted in *Lummus Company* v. *Commonwealth Oil Refining Co., supra*, "[A] strong case can be made for construing arbitration agreements as separable from the principal agreements, and as voidable only for fraud directly affecting their existence, as distinguished from representations relating to the content or making of the principal agreements." (280 F. 2d at 924)

Once it has been determined that the arbitration provision is not directly challenged and that it is broad enough to encompass the dispute, the dispute should be referred to the arbitrator.

In any event, rescission is not available in this case because Prima cannot make restitution in any form other than money payments. Accordingly, if arbitration were stayed, all that could possibly be rescinded is the arbitration provision itself, the very part of the Agreement as to which no fraud is alleged.

IV

In order to obtain a stay of a pending arbitration proceeding, the party seeking the stay in all events should be required to come forward with a demonstration sufficient to indicate that there is substance to the allegations upon which the stay is sought. This Prima has failed to do. Even if it were otherwise able to effect a rescission of the Agreement, its delay in asserting its claim has resulted in a waiver of such right. Nor has Prima shown either reliance upon the alleged misrepresentation or how

any damages could possibly have resulted therefrom. The charge of fraud is sham.

In similar circumstances, the New York Court of Appeals in *Cheney Bros.* v. *Joroco Dresses, Inc.*, 245 N. Y. 375, 157 N.E. 272 (1926) refused to stay an arbitration proceeding without indicating how it would have ruled if the charge of fraud had been substantiated. This Court should affirm the order directing arbitration whether or not it agrees with the court below as to the other issues presented by the instant case.

I

The United States Arbitration Act is applicable in determining whether the agreement of the parties to arbitrate disputes should be enforced.

A. The Agreement Evidences a Transaction Involving Interstate Commerce.

Prima has challenged, as a threshold question, whether the Agreement involves interstate commerce. We agree that if it does not, under the ruling in *Bernhardt* v. *Polygraphic Co.*, 350 U. S. 198 (1956), the application of the United States Arbitration Act (9 U.S.C. §§1-14) would have been erroneous.* However, the finding of the Second Circuit Court of Appeals that "[b]eyond peradventure the contract evidences a transaction involving interstate commerce" (R. 47) is, we submit, clearly correct.

As noted by the court below (R. 47-48), F & C turned over to Prima two lists of F & C's paint customers, which included some 175 establishments located in several states.

* Even in such event, for the reasons stated in Point IV, the order of the court below refusing to stay the arbitration proceeding should be affirmed.

As the court also noted, Prima's president had stated that the Agreement

> "* * * contemplated and intended an orderly transfer of the assets of the defendant [F & C] to the plaintiff [Prima], and further contemplated and intended that the defendant would consult, advise, assist and help the plaintiff so as to insure a smooth transition of manufacturing operations to Maryland from New Jersey, together with the sales and servicing of customer accounts and the retention of the said customers." (R. 48, quoting from R. 40-41)

Accordingly, since Prima concedes (Br. 11) that "evidence how the parties expected the contract to be performed and how it was performed is relevant to whether substantial interstate activity was contemplated," it is apparent that the commerce requirement of Section 2 of the Act has here been satisfied. See concurring opinion of Chief Judge Lumbard in *Metro Industrial Painting Corp.* v. *Terminal Const. Co.*, 287 F. 2d 382, 387 (2nd Cir. 1961), *cert. denied* 368 U. S. 817 (1961).

B. Congress Has Created a Federal Right to Enforce Arbitration Agreements.

In *Bernhardt* v. *Polygraphic Co.*, 350 U. S. 198 (1956), this Court held that Sections 1 and 2 of the United States Arbitration Act defined the field in which Congress was legislating, and that accordingly, an arbitration provision contained in a contract involving neither a maritime transaction nor commerce, as defined in the Act, was not governed by the Act. The Court then observed that the question before it was thus "whether, apart from the Federal Act, a provision of a contract providing for arbitration is enforceable in a diversity case (350 U. S. at 202)." In holding this to be a question to be resolved in

accordance with state law, the Court noted that arbitration was not a mere form of procedure within the power of the federal courts or Congress to prescribe, but rather, that it touched on substantial rights which, in the absence of an agreement involving commerce, under the doctrine of *Erie R. Co.* v. *Tompkins,* 304 U. S. 64 (1938) were governed by local law.

Bernhardt did not decide whether diversity cases involving contracts within the scope of Section 2 of the Act would likewise have to be decided under state law, or alternatively whether Section 2 creates a federal right to arbitration. The first post-*Bernhardt* case to consider this question was *Ross* v. *Twentieth Century-Fox Film Corporation,* 236 F. 2d 632 (9th Cir. 1956), wherein it was held that *Bernhardt* would support the analysis that, even though contained in a contract evidencing a transaction involving interstate commerce, an arbitration provision must be interpreted under state law.

In *Robert Lawrence Company* v. *Devonshire Fabrics, Inc.,* 271 F. 2d 402 (2nd Cir. 1959), *cert. granted* 362 U. S. 909 (1960), *dismissed pursuant to Rule 60,* 364 U. S. 801 (1960), the Court of Appeals for the Second Circuit expressly disagreed with the holding in *Ross* (271 F. 2d at 409 n. 7) and declared that Section 2 of the United States Arbitration Act

> "• • • in making agreements to arbitrate 'valid, irrevocable, and enforceable' created national substantive law clearly constitutional under the maritime and commerce powers of the Congress and that the rights thus created are to be adjudicated by the federal courts whenever such courts have subject matter jurisdiction, including diversity cases, just as the federal courts adjudicate controversies affecting other substantive rights when subject matter jurisdiction over the litigation exists." (271 F. 2d at 409).

The court stated that the intention of Congress to create a new body of federal substantive law affecting the validity and interpretation of arbitration agreements is reasonably clear (*Id.* at 406) and that such national law would be equally applicable in state courts (*Id.* at 407).*

In *American Airlines, Inc.* v. *Louisville & Jefferson C.A.B.*, 269 F. 2d 811 (6th Cir. 1959), a case decided only a few weeks prior to *Robert Lawrence* (and inaccurately characterized by Prima (Br. 13) as "in direct conflict" with *Robert Lawrence*), the Court of Appeals for the Sixth Circuit also held that the Act created national law.

> "The Federal arbitration statute, [9 U.S.C. §§1-14, 61 Stat. 669 (1947)], was enacted in exercise of the Congress' plenary power over interstate commerce. * * * Within the scope of the statute circumscribed by the Constitution, Federal law is of course paramount under the Supremacy Clause, and State law must give way." (269 F. 2d at 815).

The doctrine that the United States Arbitration Act has created national substantive law has met with resounding favor among the federal judiciary. See: *Monte* v. *Southern Delaware County Authority*, 321 F. 2d 870, 873-874 (3rd Cir. 1963); *Electronic & Missile Facilities, Inc.* v. *United States*, 306 F. 2d 554, 558 (5th Cir. 1962), reversed on other grounds, 374 U. S. 167 (1963); *Standard Magnesium*

* The instant case continues the application of this doctrine by the Court of Appeals for the Second Circuit. Since *Robert Lawrence*, it has reaffirmed its position in *Amicisia Societa Nav.* v. *Chilean Nitrate & Iodine S. Corp.*, 274 F. 2d 805 (2nd Cir. 1960), *cert. denied* 363 U. S. 843 (1960); *Metro Industrial Painting Corp.* v. *Terminal Const. Co.*, 287 F. 2d 382 (2nd Cir. 1961), *cert. denied* 368 U. S. 817 (1961); *In re Kinoshita & Co.*, 287 F. 2d 951 (2nd Cir. 1961); *El Hoss Engineer. & Transport Co.* v. *American Ind. Oil Co.*, 289 F. 2d 346 (2nd Cir. 1961), *cert. denied* 368 U. S. 837 (1961); *World Brilliance Corp.* v. *Bethlehem Steel Co.*, 342 F. 2d 362 (2nd Cir. 1965); *Marcy Lee Manufacturing Co.* v. *Cortley Fabrics Co.*, 354 F. 2d 42 (2nd Cir. 1965).

Corporation v. *Fuchs*, 251 F. 2d 455, 457-458 (10th Cir. 1957); *Younker Brothers, Inc.* v. *Standard Const. Co.*, 241 F. Supp. 17, 18 (S.D. Iowa 1965); *O'Meara* v. *Texas Gas Transmission Corp.*, 230 F. Supp. 788, 790 (N.D. Ill. 1964); *Southern Bell Tel. & Tel. Co.* v. *Louisiana Power & Light Co.*, 221 F. Supp. 364, 368 (E.D. La. 1963); and *Coastal States Gas Producing Co.* v. *Producing Properties*, 203 F. Supp. 956, 959 (S.D. Tex. 1962).

See also *Agostini Bros. Bldg. Corp.* v. *United States*, 142 F. 2d 854, 855-856 (4th Cir. 1944), a pre-*Bernhardt* case, wherein Judge Parker observed:

> "Congress gave its approval to the principle of arbitration by the enactment of the statute * * * and it manifestly intended to exercise its full power in furtherance of the principle. * * * The Senate Committee * * * rewrote the language in its present form, so as to cover only maritime transactions and transactions involving interstate and foreign commerce. Senate Report No. 536, 68th Cong.; Zip Mfg. Co. *v.* Pep Mfg. Co., D.C., 44 F. 2d 184. This was evidently done because it was realized that Congress had no power to legislate with respect to the validity of contracts generally but only as to the validity of those which related to matters subject to its control."

Prima's contention that the United States Arbitration Act does no more than regulate the manner in which federal courts are to enforce state-created rights (if any) in diversity cases would, if sustained, virtually nullify the Act. According to the position taken by Prima, if under state law an agreement to submit future disputes to arbitration is not binding and can be revoked at any time (as is the apparent case in the State of Vermont, discussed in *Bernhardt*), the Congressional endorsement

of arbitration will to that extent be to no avail in diversity cases.

There is no compelling reason so to limit the effect of the United States Arbitration Act which, by its terms, applies to arbitration provisions in all maritime transactions and contracts involving interstate or foreign commerce. Nor can it be shown that the Act was not intended to apply to diversity cases. On the contrary, that the Congressional intent was to create federal law, applicable in appropriate diversity cases, is supported in the construction given the Act by contemporary lawyers and legislators, among whom it was generally assumed to include diversity litigation. See Cohen & Dayton, *The New Federal Arbitration Law,* 12 Va. L. Rev. 265, 267 (1926); Note, 20 Ill. L. Rev. 111 (1925); Note, 69 Yale L. J. 847, 852-856 (1960).

Prima is, moreover, forced to ignore the fact that Congress specifically limited the scope of the Act to matters in respect of which it unquestionably has constitutional powers. If all that had been intended by Congress was a promulgation of federal procedure to be applied to state-created rights, the Act could have been so drafted as to apply to every case containing an arbitration provision which might for any reason be before a federal court. It is important to note that Congress did not do this. In fact, when in *Bernhardt* this Court construed Section 3 of the Act as limited to areas covered by Section 2, it expressly noted the statement in the Congressional Committee reports that "one foundation of the new regulating measure is 'the Federal control over interstate commerce and over admiralty' (350 U. S. at 202)."

Further, the "procedural" interpretation urged by Prima would render the statutory words "valid" and "irrevocable" in Section 2 mere surplusage.

As noted in *Robert Lawrence,* the Congressional intent to create a new body of substantive law applicable to arbitration agreements affecting commerce or admiralty is reasonably clear. See also the analysis of the Act made by Chief Judge Lumbard in his concurring opinion in *Metro Industrial Painting Corp.* v. *Terminal Const. Co.,* 287 F. 2d 382, 386 (2nd Cir. 1961) *cert. denied* 368 U. S. 817 (1961):

> "The report submitted by the committee of the House of Representatives which drew up the law expressly found authority for its enactment in the power over federal-court procedures granted to Congress by Article III, §1 of the Constitution and the substantive powers of Article I, §8 (interstate commerce) and Article III, §2 (admiralty). Since the Act could not stand after the Supreme Court decision in Bernhardt *v.* Polygraphic Co., supra, as an exercise of the power to control procedures in the federal courts, the alternative basis of legislative authority became the sole ground for invoking the Act in diversity cases. *If it is an exercise of the commerce and admiralty powers, the Act must apply not only to litigation in the federal courts but to suits in state courts as well."* (Emphasis added.)

Admittedly, Congress does not appear to have expressly considered the application of the Act to actions in state courts involving arbitration agreements which are contained in contracts affecting interstate commerce. It is, however, clearly more reasonable to interpret the Act as applicable to all arbitration agreements contained in contracts affecting interstate commerce—whether in state or federal courts—than to emasculate the Act by excising diversity cases from its ambit. Such frustration of the clear intent of Congress that the Act apply to diversity

cases would unjustifiably interfere with a proper exercise of the commerce power without in any way advancing the policy of the *Erie* doctrine. Indeed, the contention that the Act cannot apply to diversity cases because of *Erie* would unnecessarily require this Court to rule on the constitutional issues suggested by Mr. Justice Frankfurter in his concurring opinion in *Bernhardt*. The policy of this Court to avoid ruling on constitutional issues which are not properly before it, and the avoidance of interference with the intent of Congress that the Act apply in diversity cases, requires the approval of the *Robert Lawrence* line of cases, with its necessary corollary that the Act must have equal application to suits in the state courts.

The creation of a federal right to arbitration in contracts involving interstate or foreign commerce may properly be regarded as creating supreme national law on the subject despite the absence of a specific showing of legislative intent to that end. From the fact that Congress limited the scope of the Act to areas within its domain there may reasonably be inferred a legislative intent that the Act be applicable in state courts when the principal contract involves interstate commerce. See Note, 60 Harv. L. Rev. 262 (1946); Note, 69 Yale L. J. 847, 863-867 (1960).

The consequences of imposing an obligation upon state courts to apply the United States Arbitration Act in cases involving arbitration clauses contained in contracts involving interstate commerce hardly constitute an encroachment on important policies (in those states which still disfavor arbitration) of a magnitude sufficient to outweigh the frustration of Congressional intent which would otherwise ensue. On the other hand, the positive advantages contemplated by Congress when, in connection with interstate, foreign and maritime transactions, it provided that uniform

interpretation and effect be given to agreements to submit to arbitration, are substantial: businessmen are thereby assured that the speedy and economical resolution of disputes contemplated by their arbitration agreement will be attained.

Nor do we perceive how a holding that the United States Arbitration Act governs arbitration provisions in contracts involving interstate commerce, whether such contracts are between citizens of one state or of several states, could possibly raise constitutional questions concerning "denial of equal protection of the law and due process of law" as Prima fears (Br. 18). Since Congress may unquestionably enact national substantive law in areas within its domain, and since such law would likewise bind the state courts, the "forum shopping" which so concerns Prima would be to no avail.

Accordingly, this Court should hold that the United States Arbitration Act has created national substantive law, applicable in both federal and state courts, which governs all arbitration provisions which are contained in contracts involving interstate commerce.

II

The interpretation and effect of an arbitration provision governed by the United States Arbitration Act should be decided under federal law.

Prima has asserted that even if the Arbitration Act has created federal substantive law, such law should nevertheless be that state law governs disputes over the interpretation and effect of the arbitration clause.* However, if

* Prima also contends that disputes over the "making" of the arbitration agreement, such as those arising by virtue of claims of fraud, duress, mistake, and lack of legal capacity, should be resolved by reference to state law. However, since Prima has not attacked the arbitration provision itself as having been induced by fraud (R. 17) the question of what law should apply to a direct attack on the making

federal law were to adopt local law in matters concerning the interpretation and effect of an arbitration provision, the result would be an even greater frustration of Congressional intent than would a decision that the Act has no application to diversity cases. It would, presumably, require the application of local law even where jurisdiction was based on (e.g.) a government contract.

That the federal courts will have to apply federal law, which the courts will fashion from the policy of the Act, seems almost self-evident. See *Textile Workers* v. *Lincoln Mills*, 353 U. S. 448, 456 (1957). The Act was intended to enable and encourage parties to transactions involving interstate commerce to agree, if they so desired, that future disputes between them would be resolved by arbitration. In 1925, when the law was enacted, the common law hostility to arbitration was still rife. See discussion in *Kulukundis Shipping Co.* v. *Amtorg Trading Corp.*, 126 F. 2d 978, 982-985 (2nd Cir. 1942). Accordingly, if Congress intended no more than a federal law which would defer to local law, the Act would have been meaningless. Clearly, then, the Congressional intent was to provide a uniform, national law concerning the interpretation and effect of arbitration clauses in contracts involving interstate commerce.

Further, Prima's argument assumes that all states will enforce arbitration provisions if only the parties will make

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of the arbitration clause is not presented in this case. It may be noted that in *Moseley* v. *Electronic & Missile Facilities*, 374 U. S. 167 (1963) wherein this Court found that the issue of fraud went to the arbitration clause itself, and therefore remanded for a determination of the issue, it did not specify whether federal or state law should govern. In *American Airlines, Inc.* v. *Louisville & Jefferson C.A.B.*, 269 F. 2d 811, 816 (6th Cir. 1959), the court indicated that it would apply state and federal law. *Robert Lawrence*, on the other hand, seems to intimate that it would apply federal law. It is however unlikely that different results would ensue on questions such as fraud, duress, etc., no matter which law applies.

"use of sufficiently explicit language (Br. 22)." However, the old common law hostility to arbitration still appears to prevail in certain states which refuse to enforce agreements to arbitrate future disputes. The law of Vermont, as discussed in *Bernhardt*, is an example.* Accordingly, reference to state law would create a situation substantially different from that postured in *Auto Workers* v. *Hoosier Corp.*, 383 U. S. 696 (1966). Reference to state law for the interpretation and effect of an agreement to arbitrate future disputes would result in the complete nullification of such arbitration clauses in those states which will not, under their local law, enforce such agreements. The Arbitration Act would thus be rendered as impotent as if it had never been enacted at all.

Accordingly, it is submitted that the cases following *Robert Lawrence*, which apply federal law for the interpretation and effect of an arbitration agreement, are correct and that the contrary position of *Ross* v. *Twentieth Century-Fox Film Corporation*, 236 F. 2d 632 (9th Cir. 1956) should be rejected.

III

A charge of fraudulent inducement of the principal contract is referable to arbitrators if encompassed by the particular arbitration agreement.

In *Robert Lawrence*, the Court of Appeals for the Second Circuit set forth four questions to be resolved in order for a court to decide whether or not a charge of fraud in the inception of a contract was arbitrable:

> "(1) is there anything in the Arbitration Act or elsewhere to prevent the parties from making a

* For a discussion of the enforcement afforded arbitration provisions in various states, see Aksen, *Arbitration of Disputes Arising From Architectural, Engineering and Construction Contracts*, Am. Inst. of Architects Journal, February and April, 1964; see also Note, 56 Colum. L. Rev. 902, 903-904 (1956).

> binding agreement to arbitrate any disputes thereafter arising between them, including a dispute that there had been fraud in the inception of the contract; (2) is the exception of Section 2, 'save upon such grounds as exist at law or in equity for the revocation of any contract' applicable if such an agreement to arbitrate has been made and the only fraud charged is fraud in inducing the purchase of goods, rather than fraud in connection with the making of the agreement to arbitrate; (3) did the parties in the case before us make a binding agreement to arbitrate; and (4) is the arbitration clause broad enough to cover the charge of fraud." (271 F. 2d at 409)

Answering the first question, the court found

> "no public policy that would stand as a bar to an agreement of such obvious utility. • • • Indeed, the difference between fraud in the inducement and mere failure of performance by delivery of defective merchandise depends upon little more than legal verbiage and the formulation of legal conclusions." (271 F. 2d at 410)

Other jurisdictions agree that no public policy would prevent the enforcement of such an agreement. *Lummus Company* v. *Commonwealth Oil Refining Co.*, 280 F. 2d 915, 924 (1st Cir. 1960), *cert. denied* 364 U. S. 911 (1960); *Nelley* v. *Baltimore City*, 224 Md. 1, 166 A. 2d 234 (1960); *Amerotron Corp.* v. *Maxwell Shapiro Woolen Co.*, 3 A.D. 2d 899, 162 N.Y.S. 2d 214 (N. Y. App. Div., 1st Dept. 1957) affirmed w/o opinion, 4 N. Y. 2d 722, 148 N.E. 2d 319 (1958); *McElwee-Courbis Construction Co.* v. *Rife*, 133 F. Supp. 790 (M.D. Pa. 1955).

The court, in *Robert Lawrence*, then enunciated its belief that the Arbitration Act envisaged a distinction between the principal contract and the arbitration agreement

therein. Thus, a charge of fraud as to the principal contract would not vitiate the arbitration agreement unless the arbitration agreement was itself fraudulently induced.

By this approach, the court below limited its inquiry to whether the parties had made a binding agreement to arbitrate and whether the arbitration clause they used was broad enough to cover the charge of fraud. Having satisfied itself as to these two matters, the court below dismissed Prima's appeal as frivolous, thereby affirming the order directing arbitration.

A. The Arbitration Agreement of the Parties Encompasses Disputes Involving Charges of Fraudulent Inducement.

Prima has asserted that "it is a ridiculous conclusion to believe that men consciously and separably would agree to arbitrate any fraud that would give rise to an action to set aside their agreement (Br. 26)." On the contrary, not only is such a conclusion not "ridiculous" but it is entirely consistent with the reasons why businessmen voluntarily agree that they will arbitrate, rather than litigate, their future disputes. Certainly, parties to a business transaction do not expect fraud. Nor do they expect breach of warranty, failure of performance, lack of good faith, or any other dispute to arise. An arbitration agreement is selected as a means for resolving disputes which the parties hope and expect will never arise. In *Wilko* v. *Swan*, 346 U. S. 427, 431-432 (1953), this Court noted the Congressional recognition of arbitration as a desirable alternative to the complications, delay, and expense of litigation. The inclusion of an arbitration agreement in literally thousands of contracts, including the Agreement at issue in this case, demonstrates that businessmen and their attorneys are aware of the same merits of arbitra-

tion which Congress recognized. It may similarly be assumed that they are aware of its shortcomings, some of which are recounted in *Bernhardt*.

However, the fact remains that in the Agreement in this case Prima voluntarily determined that the merits of arbitration outweigh its shortcomings, for it chose of its own accord to enter into a solemn, written agreement that "Any controversy or claim arising out of or relating to this Agreement, or the breach thereof, shall be settled by arbitration * * *" (R. 26). This language is clearly broad enough to compel a finding that the parties intended to arbitrate precisely such a dispute as has now arisen. Such was the opinion of the courts which decided *In re Kinoshita & Co.*, 287 F. 2d 951, 953 (2nd Cir. 1961), *Lummas Company* v. *Commonwealth Oil Refining Co.*, 280 F. 2d 915, 931 (1st Cir. 1960), *cert. denied* 364 U. S. 911 (1960) and *Electronic & Missile Facilities, Inc.* v. *United States*, 306 F. 2d 554, 555 n.2 (5th Cir. 1962), reversed on other grounds, 374 U. S. 167 (1963) in each of which substantially the same language was either discussed or involved.

Similar arbitration agreements have likewise been held to encompass disputes involving fraud. In *Amerotron Corp.* v. *Maxwell Shapiro Woolen Co.*, 4 N. Y. 2d 722, 148 N. E. 2d 319 (1958) the New York Court of Appeals affirmed without opinion the decision below (3 A.D. 2d 899, 162 N.Y.S. 2d 214) that an agreement to arbitrate "any controversy or claim arising under or in relation to" the contract was broad enough to require an arbitrator to determine the question of fraudulent inducement.*

* The clause does not appear in the New York Reports. It may be found in the opinion of the Supreme Judicial Court of Massachusetts in *Maxwell Shapiro Woolen Co.* v. *Amerotron Corp.*, 339 Mass. 252, 254n, 158 N.E. 2d 875 (1959) wherein that court dealt with the Massachusetts court proceedings which had been stayed pending the arbitration in New York.

In *M. W. Kellogg Co.* v. *Monsanto Chemical Co.*, 9 A.D. 2d 744, 745, 192 N.Y.S. 2d 869 (N. Y. App. Div. 1st Dept. 1959), the court affirmed reference to arbitration of a dispute concerning fraudulent inducement where the arbitration agreement encompassed "All claims, disputes, differences and controversies arising under or in connection with the agreement."

In *Fabrex Corporation* v. *Winard Sales Company*, 23 Misc. 2d 26, 200 N.Y.S. 2d 278 (Sup. Ct., N. Y. Co. 1960), the court held that the question of fraudulent inducement was for the arbitrator where the arbitration agreement provided that "Any controversy arising under or in relation to this contract or order or any modification thereof shall be settled by arbitration."

Finally, in *Nelley* v. *Baltimore City*, 224 Md. 1, 166 A. 2d 234 (1960), the court regarded an agreement that "the Director of Public Works will be the referee in case any question shall arise between the Contractor and the City touching the Contract, and his determination, decision and/or estimate shall be final and conclusive upon the Contractor * * *" (224 Md. at 6, 166 A. 2d at 236), as "broad enough to include disputes involving claims of concealment or misrepresentation in the inducement of the substantive contract; * * *" (224 Md. at 14, 166 A. 2d at 240). It is particularly noteworthy that this case was decided some four years prior to the instant Agreement by the highest court of the state in which Prima is incorporated and has its principal place of business.

It is therefore clear that the arbitration agreement entered into by Prima is broad enough to mandate a finding that it was the intention of the parties to include the issue of fraud in the inducement of the principal contract as arbitrable. Prima's efforts to evade arbitration reflect

no more than a one-sided change of mind which is forbidden by Section 2 of the United States Arbitration Act.

B. The Nature of the Remedy Sought Should Not Affect the Validity, Irrevocability or Enforceability of the Arbitration Agreement.

Prima contends that its choice of remedy (*i.e.*, the fact that its complaint seeks rescission of the Agreement rather than damages) requires a court, and not an arbitrator, to hear and determine the issue of fraud in the inception of the Agreement. In rejecting this contention, the court below held, *as a matter of federal law,* that an arbitration agreement is separable from the contract within which it is contained, and if there is no allegation that the clause itself was fraudulently induced, and if the clause is broad enough to cover a dispute over fraudulent inducement, "the resolution of whether there was in fact fraud in the inducement is properly the province of the arbitrators and not of the court." (R. 49)

Prima has not argued, as indeed it cannot, that an arbitrator who is qualified to decide the issue of fraud in the context of a claim for damages is somehow not as well qualified to pass upon the same issue of fraud if it arises in the context of a claim for rescission. What Prima does argue is that the ruling below has "destroyed the petitioner's inherent right to elect its remedy." (Br. 24)

Of course, Prima is confusing the concept of remedy with the concept of forum. By consenting to an arbitration clause Prima has voluntarily chosen a forum, and has waived its right to a future change of such forum. It has not, however, waived its right to seek rescission of the

Agreement, which the arbitrators are free to grant, nor has the court below in any way intimated to the contrary.*

Prima's argument comes down to the proposition that a party may abrogate an otherwise "valid, irrevocable, and enforceable" (9 U.S.C. §2) agreement to arbitrate disputes simply by instituting an action for rescission of the principal contract without in any way attacking the arbitration agreement itself. A similar argument was rejected in *Robert Lawrence* wherein the court stated:

> "That the Arbitration Act envisages a distinction between the entire contract between the parties on the one hand and the arbitration clause of the contract on the other is plain on the face of the statute. Section 2 does not purport to affect the contract as a whole. On the contrary, it makes 'valid, irrevocable, and enforceable' only a 'written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction'; and Section 3 provides for the granting of a stay in any suit or proceeding in the federal courts 'upon an issue referable to arbitration under an agreement in writing for such arbitration.'" (271 F.2d at 409-410.)

Section 4 of the Act lends further support to the concept of separability, for it provides for an order directing the parties to proceed with arbitration if the court is "satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue." Section 4 goes on to provide that: "If the making of the arbitration

* Section 42 of the Commercial Arbitration Rules of the American Arbitration Association provides in part: "The Arbitrator may grant any remedy or relief which he deems just and equitable and within the scope of the agreement of the parties, including, but not limited to, specific performance of a contract."

agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof."

Since Prima has nowhere alleged any fraud with respect to the making of the arbitration agreement itself, that agreement should not be disregarded when Prima tries to rescind the principal contract. Indeed, if the charge of fraud were directed to the arbitration agreement, Section 4 of the Arbitration Act would afford a means for summary determination of the question. Certainly, therefore, when the charge does not even involve the agreement to arbitrate, there can be no compelling reason why an arbitration proceeding should have to await the resolution of the question of fraud by a plenary trial.

In *Lummus Company* v. *Commonwealth Oil Refining Co.*, 280 F.2d 915, 924 (1st Cir. 1960) *cert. denied* 364 U. S. 911 (1960), the Court of Appeals for the First Circuit expressed the view that:

> "[A]ny other approach sets the stage for delaying action, and invites the injured party to cast what is basically a claim for breach of warranty or failure to perform, which would be arbitrable, into an action based on fraudulent inducement * * *. [A] strong case can be made for construing arbitration agreements as separable from the principal agreements, and as voidable only for fraud directly affecting their existence, as distinguished from representations relating to the content or making of the principal agreements."

Nor is the doctrine of separability novel, or unique to the federal law suggested in *Robert Lawrence.* In Nussbaum, *The Separability Doctrine in American and Foreign Arbitration,* 17 N.Y.U.L.Q. 609 (1940), the author reviews the European doctrine that the arbitration agree-

ment may have an independent existence and confer on the arbitrators the exclusive power to decide on the validity of the main agreement. He concludes that the trend of European courts is definitely to entrust to the arbitrator the decision on the defenses of fraud and mistake, though decisive of the validity of the main contract.

The concept of separability would seem also to be supported by *Moseley* v. *Electronic & Missile Facilities,* 374 U. S. 167 (1963) wherein this Court reversed a decision of the Court of Appeals for the Fifth Circuit (which had applied the theory of separability) on the ground that "the issue [of fraud] goes to the arbitration clause itself, since it is contended that it was to be used to effect the fraudulent scheme (374 U. S. at 171)." Had this Court desired to reject the theory of separability, it could have expressly done so in *Moseley* and not have had to reach the question whether the arbitration clause was "to be used to effect the fraudulent scheme."

By limiting their inquiry to what the parties intended by the language of their arbitration agreement, other courts have likewise concluded that when rescission was sought on the basis of fraudulent inducement, the issue was for the arbitrators.

Thus, in *Fabrex Corporation* v. *Winard Sales Company,* 23 Misc. 2d 26, 27, 200 N.Y.S. 2d 278, 280 (Sup. Ct. N. Y. Co. 1960), the court held in staying an action that sought rescission:

> "Where an arbitration clause is broad and all inclusive, a request for rescission, either in a pending action or in a demand for arbitration, based upon fraud in the inducement, will be left for determination of the arbitrators (Citations omitted.) * * * In the case before me the arbitration clause is of the broadest scope. Clearly, such a clause may provide for the determination of such questions of fraud and rescission."

The same result was reached in *Matter of Amphenol Corporation,* 49 Misc. 2d 46, 266 N.Y.S. 2d 768 (Sup. Ct. N. Y. Co. 1965), affirmed w/o opinion, 25 A.D.2d 497, 267 N.Y.S. 2d 477 (N. Y. App. Div., 1st Dept. 1966), wherein the party seeking rescission on the ground of fraudulent inducement had instituted arbitration proceedings to determine that issue. The Court denied a motion by the party opposing rescission to stay such arbitration.

Thus, the New York courts require arbitration of the issue of fraudulent inducement even where the relief sought is rescission, and they do so whether the party seeking the rescission is the one requesting or the one resisting the arbitration proceeding. The scope of the arbitration agreement is decisive, as it should be.

Since an arbitrator could unquestionably determine that there had been no meeting of the minds where fraud, or breach of warranty, or mutual mistake is asserted as a defense in an arbitration proceeding, and since it would not be seriously contended that such determination *eo instanti* divested the arbitrator of his power to decide that there was in fact no binding contract, the result should not differ when the same relief is requested affirmatively. In both instances, the arbitrator's power is derived from a then existing contract. To contend that the arbitrator's authority is dependent upon whether the validity of the principal contract is attacked defensively rather than affirmatively is to sacrifice substance to accidents of form.

In *Matter of Grayson-Robinson Stores,* 8 N. Y. 2d 133, 138, 168 N.E. 2d 377 (1960), the New York Court of Appeals observed:

> "Arbitration is by consent and those who agree to arbitrate should be made to keep their solemn, written promises. Such is New York State's public

> policy, plainly written in article 84 of the Civil Practice Act. The courts should follow a 'liberal policy of promoting arbitration both to accord with the original intention of the parties and to ease the current congestion of court calendars.' Lawrence Co. *v.* Devonshire Fabrics, 2 Cir., 271 F.2d 402, 410."

It is submitted that this Court should not tolerate tactics designed solely to frustrate and delay an arbitration proceeding when the relief sought in litigation is just as available in arbitration. Rather, this Court should adopt a policy which will not permit attempts to evade the Congressional mandate that arbitration agreements are "valid, irrevocable, and enforceable."

C. In Any Event, Prima's Demand for Rescission Is Without Foundation.

Even assuming *arguendo* that Prima had made a *prima facie* showing of fraud, it could not, because of the subject matter of the Agreement, effect a rescission. Thus, its casting of its action in terms of that remedy in order to invoke a claimed distinction between an action seeking rescission and one seeking damages is a cynical and sterile academic exercise.

In the instant case, F & C gave Prima its customer lists, its consulting services, and its covenant of non-competition. Prima was to pay to F & C a percentage of its receipts on the sales it made to the former customers of F & C. Since Prima has made substantial sales to these customers, and would therefore owe money to F & C, it is clear that Prima has already received benefits which it is unable to return in any form other than by payment therefor. Moreover, Prima cannot divest itself of its knowledge of F & C's customers, nor has

Prima offered to stop making sales to such customers. (Interestingly, if Prima ceased making sales to the F & C customers, there would be no need to sue for rescission since Prima's only liability to F & C, except with respect to sales already completed and not capable of rescission, is based on future sales to such customers). Since any substituted form of restitution would perforce take the form of money payments to F & C, the end result would be identical with a successful action for damages whereby Prima would offset its contractual payments by the amount of the damage award it obtained.

The result of permitting a rescission action to forestall an arbitration proceeding would, therefore, be the same as in the analogous situation presented in *Lummus Company* v. *Commonwealth Oil Refining Co.*, wherein the Court stated:

> "It is significant that we have nowhere found a case where a party has succeeded in effecting rescission, and has at the same time retained *in its own possession* all of the very res which constituted the tendered performance of the other side. Even assuming that such a result might be allowed 'if justice cannot otherwise be done,' we do not believe that a desire to avoid arbitration constitutes such an imperative where nothing else in the case suggests that rescission and restitution are necessary to afford Commonwealth compensation for its injury. To allow Commonwealth to rescind and to keep the fruits of the contracts by permitting it to make substituted restoration would be just another way of allowing it to rescind merely the arbitration clauses, the very part as to which there was no fraud." (Emphasis by court). 280 F.2d at 929.

It is accordingly submitted that each and every argument Prima has advanced as to why arbitration should not now proceed is without merit.

IV

This Court should affirm the refusal to stay arbitration since Prima has failed to demonstrate substance to its claim of fraud.

Whether or not the Arbitration Act applies and whether or not the issue of fraud or the remedy of rescission is held by this Court to be determinable by a court, and not by an arbitrator, the order of the court below refusing to stay the pending arbitration proceeding should nevertheless be affirmed because Prima has not come forward with any facts which would give substance either to its charge of fraud or to its request for rescission.

In the various contexts in which the appropriateness of injunctive relief has been raised, the federal courts have consistently required, before injunctive relief will be granted, a showing not only that irreparable injury would otherwise result but that there is reasonable probability of success on the merits. *Continental Oil Company* v. *Frontier Refining Company*, 338 F.2d 780, 781 (10th Cir. 1964); *H. E. Fletcher Co.* v. *Rock of Ages Corporation*, 326 F.2d 13, 17 (2nd Cir. 1963); *Societe Comptoir de L'Indus., etc.* v. *Alexander's Dept. St.*, 299 F.2d 33, 35 (2nd Cir. 1962); *Crane Company* v. *Briggs Manufacturing Company*, 280 F.2d 747, 749 (6th Cir. 1960).

Prima has moved pursuant to Fed. R. Civ. P. 65, to stay a pending arbitration proceeding. It is submitted that the same test should apply here as is applied in granting preliminary injunctions in other contexts. The application of the test of reasonable probability of success to the facts of the instant case will confirm that Prima was not entitled to a stay of the pending arbitration proceedings.

Such was the approach taken by the New York Court of Appeals in *Cheney Bros. v. Joroco Dresses, Inc.*, 245 N. Y. 375, 157 N.E. 272 (1926). The court had before it for review a 3-2 holding of the intermediate appellate court which had stayed an arbitration proceeding on the ground that "whether or not the contract was fraudulently induced raises an issue of fact which must be tried before the right to arbitration under the contract may be enforced (218 App. Div. 652, 219 N.Y.S. 96)." The New York Court of Appeals unanimously reversed without having to reach the ground upon which the court below had based its decision. The Court of Appeals found that no fraud in procuring the contracts had been shown, and accordingly it refused to allow an unsubstantiated claim of fraud to stay an arbitration proceeding. Under these circumstances, the court concluded that "the question whether arbitration could be compelled to determine an issue made as to the procurement of a contract by fraud is, therefore, not before us and will not now be determined." (245 N. Y. at 376-377).

Similarly, in *Lummus Company* v. *Commonwealth Oil Refining Co.*, the Court of Appeals for the First Circuit reversed an order staying arbitration holding, after reviewing the alleged fraud, that:

> "• • • If the agreements to arbitrate are separable from the principal agreements no ground has been shown for their avoidance. If they are not separable, we hold it has shown no basis for rescission at all.
>
> "Since Commonwealth failed to raise a substantial issue as to the making or the existence of the contracts, it was not entitled to a preliminary stay of the arbitration proceedings." (280 F.2d at 930-931.)

In *Robert Lawrence*, a case decided under the doctrine of separability, the Court of Appeals for the Second

Circuit recognized that if the arbitration clause itself were induced by fraud, there could obviously be no arbitration. However, the court indicated that it would grant a stay and order a judicial trial only "if the party charging fraud shows there is substance to his charge." (271 F.2d at 411)

The Record herein indicates that Prima has failed to show the slightest substance to its belated claim for rescission or to its irresponsible cry of fraud. Accordingly, this Court could affirm the order below, refusing to stay the arbitration proceeding, without even reaching the other questions presented by this case.

A. Prima Has Waived Any Right It May Have Had To Rescind the Contract.

Prima's unconscionable behavior in remaining silent for eleven full months after F & C's alleged oral misrepresentation of solvency came to light, while continuing to exploit the assets acquired and the consulting services offered, clearly bars it from now obtaining rescission of the Agreement irrespective of the other reasons set forth in Point III above as to why the remedy of rescission is not here available.

As this Court stated in *Grymes* v. *Sanders*, 93 U. S. 55, 62 (1876):

> "Where a party desires to rescind upon the ground of mistake or fraud, he must, upon the discovery of the facts, at once announce his purpose and adhere to it. If he be silent, and continue to treat the property as his own, he will be held to have waived the objection, and will be conclusively bound by the contract, as if the mistake or fraud had not occurred. He is not permitted to play fast and loose. Delay and vacillation are fatal to the right which had before subsisted."

This general rule of law is followed by the State of Maryland where Prima is incorporated and has its principal place of business, by the State of New Jersey where F & C is incorporated and by the State of New York where the arbitration is to take place. See *Wolin* v. *Zenith Homes, Inc.*, 219 Md. 242, 146 A. 2d 197 (1959), *cert. denied* 361 U. S. 831 (1959); *Dover Shopping Center, Inc.* v. *Cushman's Sons, Inc.*, 63 N. J. Super. 384, 164 A. 2d 785 (App. Div. 1960); *Ajamian* v. *Schlanger*, 20 N. J. Super. 246, 89 A. 2d 702 (App. Div. 1952); *New York Tel. Co.* v. *Jamestown Tel. Corporation*, 282 N. Y. 365, 372, 26 N.E. 2d 295 (1940).

Prima's conduct is surely such as to require a court to refuse to grant rescission of the Agreement, especially when the Record does not disclose a single reason to counter the legal conclusion that Prima's delay has resulted in a ratification of the Agreement.

B. There Is No Substance To Prima's Claim of Fraud.

Prima's complaint nowhere alleges or suggests that it has been damaged in any way by the alleged misrepresentation of solvency. Prima merely claims that in reliance on F & C's alleged oral representation, it was induced to accelerate the closing date and enter into the Agreement (R. 20). It may be noted that the Agreement contains no representation of solvency and states that the "Agreement embodies the entire understanding of the parties • • •" (R. 27)

Prima cannot demonstrate that it was damaged. The Agreement entered into by the parties requires Prima to pay F & C a stated percentage of Prima's receipts from sales to former F & C customers whose names were disclosed to Prima pursuant to the Agreement. No minimum payments are guaranteed to F & C. Thus, the

extent of Prima's obligation to F & C depends solely upon the volume of sales made by Prima. If Prima makes no sales, F & C is not entitled to any payments. Since Prima's obligation depends only upon the value to it of the assets sold, there is no way it can demonstrate any damages.

To sustain an action based upon fraud, the party claiming to have been defrauded must make a showing of damages.

> "Undoubtedly in an action at law for fraud or deceit, since the action sounds in damage, the plaintiff must prove damage to establish a right to recover." *United States* v. *Dunn*, 268 U. S. 121, 131 (1925).

The same rule applies in those states which have any connection with this transaction.

> "Legal fraud consists of a material representation of a presently existing or past fact, made with knowledge of its falsity, with the intention that the other party rely on it, and he does so rely to his damage. In equitable fraud the second element (knowledge) is not necessary, but the other four are essential." *Dover Shopping Center, Inc.* v. *Cushman's Sons, Inc.*, 63 N. J. Super. 384, 391, 164 A.2d 785, 789 (App. Div. 1960).

The elements of an action based upon fraud under the law of Maryland are the same as those required under the law of New Jersey. See *Lambert* v. *Smith*, 235 Md. 284, 201 A.2d 491, 493 (1964); *Cox* v. *Tayman*, 182 Md. 74, 32 A.2d 368, 370 (1943).

Similarly, the New York Court of Appeals has held:

> "To maintain an action based on fraudulent representations, whether it be for the rescission of a contract or, as here, in tort for damages, it is sufficient to show that the defendant knowingly uttered a falsehood intending to deprive the plain-

> tiff of a benefit and that the plaintiff was thereby deceived and damaged." *Channel Master Corp.* v. *Aluminum Ltd.*, 4 N.Y.2d 403, 406-407, 151 N.E.2d 833 (1958).

Nor is Prima's allegation of reliance on the alleged misrepresentation substantiated by the Record. F & C's assertion that "plaintiff's [Prima's] reliance, as manifested in the negotiations and in the Consulting Agreement, as well as in its conduct subsequent to October 14, 1964, was upon the customer lists of defendant [F & C] which were delivered to plaintiff on October 7, 1964, on the agreement of defendant not to compete, and on the availability of Jerome K. Jelin, an officer of defendant, to render consulting services • • •" (R. 17) remains uncontradicted. Prima submitted an affidavit in which it specifically referred to, and attempted to dispose of, the assertions made by F & C; however, it did not and could not deny the statement just quoted (R. 36-38; R. 39-41).

It is obvious that Prima has tried to delay the early resolution of the controversy which it raised only after its first payment to F & C was overdue. It has done so because of the economic coercion it hoped to wield by delaying payments otherwise due to F & C. In *Necchi Sewing Machine Sales Corp.* v. *Necchi, S. p. A.*, 369 F.2d 579, 582 (2nd Cir. 1966), Judge Kaufman noted in his dissenting opinion that:

> "Speed is one of the great advantages of commercial arbitration. By resorting to a professional arbitrator to settle their disputes, the parties to a contract are able to avoid the delays, often measured in terms of years, due to crowded court dockets. But, if one or both of the parties to an arbitration agreement is permitted to engage in the 'protracted bickering and the delays,' or the

'extravagant and involved moves and counter-moves in state and federal courts,' such as the majority recognizes have occurred in the present case, commercial arbitration loses one of its main virtues. I find distasteful any practice which makes the Court a puppet to the tactics and manipulations of the parties."

The foregoing quotation is singularly apposite to the delays caused by Prima's naked and intemperate allegations of fraud, and this Court should reject such tactics out of hand.

CONCLUSION

For the foregoing reasons, the order of the United States Court of Appeals for the Second Circuit should be affirmed.

Dated: New York, N. Y.
February 28, 1967

Respectfully submitted,

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MAR 1 1967

SUPREME COURT, U.S.

IN THE

Supreme Court of the United States

October Term, 1966

No. 343

PRIMA PAINT CORPORATION,

Petitioner,

v.

FLOOD & CONKLIN MFG. CO.,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

MOTION OF THE AMERICAN ARBITRATION ASSOCIATION FOR LEAVE TO FILE A BRIEF AS *AMICUS CURIAE*

and

BRIEF OF THE AMERICAN ARBITRATION ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

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IN THE

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Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

MOTION OF THE AMERICAN ARBITRATION ASSOCIATION FOR LEAVE TO FILE A BRIEF AS *AMICUS CURIAE*

Pursuant to Rule 42 of the Rules of this Court, the American Arbitration Association, Inc., hereinafter called "AAA," by its Arbitration Law Committee, Whitney North Seymour, Chairman, and four members appointed as a subcommittee, Sol N. Corbin, Osmond K. Fraenkel, William J. Isaacson, and H. H. Nordlinger, hereby respectfully moves for leave to file a brief annexed hereto as *amicus curiae* in this case. The written consent of respondent has been obtained. The consent of the petitioner was requested but refused.

The AAA is a non-profit membership corporation organized in 1926 and existing under the laws of the State of New York. Its purposes are, among others, as stated in its presently effective Certificate of Incorporation:

> "1. To promote the knowledge and spread the use and the remedy of arbitration throughout the United States and other countries. * * *
>
> * * *
>
> "5. To disseminate knowledge of the value of the application of arbitration, mediation and conciliation, of desirable systems thereof, and of their practical operation as methods for the disposition of commercial and industrial disputes.
>
> "6. To cooperate with Bar Associations, International, American, State and Local, in the proper delimitations of the fields of arbitration, mediation and conciliation, and the coordination and the administration of the law, machinery and systems of arbitration, mediation and conciliation."

The AAA maintains twenty-two regional offices which are responsible for the administration of arbitrations conducted pursuant to its Rules throughout all fifty states. The AAA conducts educational seminars on all aspects of arbitration and is today the primary organization concerning itself exclusively with arbitration in this country.

The brief which the AAA seeks to submit is necessitated by the fact that the interest by the business community in the issues involved in this case far transcends the interest of the immediate litigants. The resolution of these issues will have a far-reaching effect upon literally untold thousands of commercial contracts if the decision of the U. S. Court of Appeals for the Second Circuit is reversed.

The AAA is not concerned with the outcome of this case so far as it affects the particular parties. But as a sponsor and leader of the development of commercial arbitration, the AAA is in a unique position to advance the interest of the commercial world in the sound and proper construction of commercial arbitration and agreements to arbitrate.

For the reasons heretofore assigned, and upon the proposed *amicus* brief annexed hereto, the AAA respectfully requests that this motion be granted.

Dated: February 16, 1967.

Respectfully submitted,

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IN THE

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FLOOD & CONKLIN MFG. CO.,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF OF THE AMERICAN ARBITRATION ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

Statement of Interest

This brief *amicus curiae* is filed on behalf of the American Arbitration Association, Inc., hereinafter AAA or Association, a non-profit membership corporation organized in 1926 and existing under the laws of the State of New York, and a sponsor and leader in the development of commercial arbitration.

As such, the Association is vitally interested in the determination as to which law, state or federal, will govern the construction, application and effect of arbitration agreements in interstate commerce cases. This decision may vitally affect both the extent and effective use of arbitration in this country. The Association, as well as the commercial world in general, is also vitally interested in the legal significance to be accorded the broad arbitration clause, recommended by the Association and widely used in contracts throughout the United States. Unless the decision of the United States Court of Appeals for the Second Circuit is sustained, the use of commercial arbitration might be seriously curtailed and the obligation of an innumerable number of contracts called into question.

Since the Association has no interest in this case as between the parties thereto, but only in the enunciation of a sound and workable law of arbitration, it takes no position as to whether in the instant case the contract evidences a transaction involving interstate commerce. For purposes of this argument, interstate commerce is assumed.

Questions Presented

Whether the Federal Arbitration Act is applicable to an arbitration provision in a contract evidencing a transaction involving interstate commerce, where the sole basis of jurisdiction in the federal court is diversity of citizenship.

Whether under the Federal Arbitration Act, a claim that the entire contract was fraudulently induced is arbitrable under a broad arbitration clause, whatever the relief sought.

Statutes Involved

Amicus respectfully refers the Court to the statutes involved as enumerated and incorporated in the brief for petitioner.

Statement of the Case

Amicus respectfully refers the Court to the statement of the case contained in the opinion of the United States Court of Appeals for the Second Circuit incorporated in the Transcript of Record.

Summary of Argument

The Federal Arbitration Act, enacted under the commerce clause power of Congress, created a national substantive law governing arbitration agreements in transactions involving interstate commerce. As federal substantive law, it must be applied by a federal court to an arbitration agreement when interstate commerce is involved, even where the sole jurisdictional ground is diversity of citizenship.

Under this federal law, the broad arbitration clause as recommended by the AAA and widely used must be held to evidence an intent by the parties to arbitrate a dispute over fraud in the inducement, where there is no allegation that the arbitration provision was itself fraudulently procured. Since an arbitrator is empowered to grant equitable relief, the remedy sought, in this case, rescission, has no bearing on the outcome.

ARGUMENT

POINT I

The Federal Arbitration Act enacted "substantive" federal law meant to apply to an arbitration agreement contained in a contract evidencing a transaction involving interstate commerce, where jurisdiction exists solely by diversity of citizenship.

The question presented is whether the Federal Arbitration Act is grounded merely on the power of Congress to create procedural law for the federal court system (Article III, Section 1 of the Constitution), or whether it is based on Congressional authority to enact substantive federal law, specifically under the commerce clause, for transactions involving interstate commerce (Article I, Section 8).

One of the traditional methods employed to answer such a question is to ascertain the intent of the framers of the legislation, through an analysis of the legislative history. Yet, probably due to the almost complete lack of opposition to the Bill, there was little Congressional discussion of it.[1]

Despite the dearth of historical analysis, there is clear authority for the proposition that the Federal Arbitration Act was grounded in the Congressional authority to enact substantive law under the commerce clause.

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1. "It is indeed remarkable how so important and far-reaching legislation can emerge from Congress with such a dearth of intelligent discussion." Baum & Pressman, *The Enforcement of Commercial Arbitration Agreements in the Federal Courts*, 8 N.Y.U.L. Rev. 428, 430, f.121 (1931).

Specifically relevant is the statement of the Committee of the Judiciary, from which the bill, as finally enacted, was reported. The Committee noted that:

> "The remedy is founded also upon the Federal control over interstate commerce, and over admiralty. The control over interstate commerce reaches not only the actual physical interstate shipment of goods but also contracts relating to interstate commerce." H.R. Rep. No. 96 (68th Congress, 1st Sess., 1924), p. 1.

The federal control over interstate commerce and admiralty is, of course, substantive. This view, that the Act was founded upon this control, seems to have been relied on by this Court in *Bernhardt* v. *Polygraphic Co. of America*, 350 U. S. 198, 76 S. Ct. 273, 100 L. Ed. 199 (1956).

In *Bernhardt*, the issue was whether Section 3 of the Act, not specifically limited by its terms to interstate commerce, could be applied by a federal court in an intrastate commerce case arising by diversity of citizenship.

This Court held that Section 3 could not be applied, for two reasons. First, because Congress did not have the power, after *Erie R.R.* v. *Tompkins*, 304 U. S. 64 (1938), to create the applicable law for an intrastate commerce case, since a state-created right was indisputably at issue.

The second reason offered by this Court was for present purposes, even more significant. It first noted that Section 3 could not be read independently, but had to be interpreted in the context of the entire Act, particularly Sections 1 and 2. "There is no intimation or suggestion in the Committee Reports that §§1 and 2 cover a narrower field

than §3" (350 U. S. at p. 201). In concluding that the Act as a whole, and therefore §3, was never intended to apply to cases involving intrastate commerce, this Court found persuasive the above quoted language from the House Report on the bill, that "one foundation of the new regulating measure is 'the Federal control over interstate commerce and over admiralty'" (350 U. S. at p. 202).

The Constitutional questions alluded to in Mr. Justice Frankfurter's concurrence exist only if the Act is characterized as procedural. Once it is established that the Act was based rather on Congress' substantive power over interstate commerce, clearly implied in the majority opinion, no such Constitutional impediments remain.

It has been noted, with particular reference to *Red Cross Line* v. *Atlantic Fruit Co.*, 264 U. S. 109, 44 S. Ct. 274, 68 L. Ed. 582 (1924), that at the time the Federal Arbitration Act was passed, arbitration was characterized as relating to remedy.[2] The statement is accurate and undoubtedly this remedial label then attached to arbitration is largely responsible for today's difficulty in characterizing the Arbitration Act. The fact that arbitration was so characterized, however, does not mean that the Act was grounded on a procedural base.

The overriding difficulty implicit in a characterization of the Act as purely procedural is an inability to explain

2. It is not so characterized today. See *Bernhardt* at p. 203:

"For the remedy by arbitration, whatever its merits or shortcomings, substantially affects the cause of action created by the State. The nature of the tribunal where suits are tried is an important part of the parcel of rights behind a cause of action. The change from a court of law to an aribtration panel may make a radical difference in ultimate result."

its limitation to interstate commerce and maritime transactions.

> "The Congress, finding it expedient and desirable to require the courts of the United States to repudiate common law revocability and non-enforceability of written arbitration agreements covering controversies arising out of 'maritime transactions' and 'commerce' should, it seems, have found it equally expedient and desirable to accomplish the same objectives with respect to like written arbitration agreements covering other and different controversies over which the courts of the United States take jurisdiction by reason of diversity of citizenship of the parties or otherwise."[3]

The fact that Congress did not find it expedient and desirable to accomplish these same objectives with reference to controversies other than those arising out of "maritime transactions" and "commerce" seems explicable only if Congress considered it either necessary or desirable to limit itself to subject matter within its constitutional legislative authority. Whatever the motivation, Congress clearly intended to bedrock the Act in the commerce power.

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3. Sturges & Murphy, *Some Confusing Matters Relating to Arbitration Under the United States Arbitration Act*, 17 Law & Contemporary Problems 580, 587 (1952).

Note, 69 Yale L. J. 847, 858 (1960). "Finally, if the act is exclusively remedial, Congress probably would not have restricted it to contracts evidencing transactions in maritime and interstate or foreign commerce. Rather, the act would have applied in all actions arising in federal courts. Congress probably limited the scope of Section 2 to maritime and interstate or foreign commerce because they felt this necessary to contain the act within Constitutional bounds—the House Report an the bill stated that federal control over interstate commerce and admiralty was relied upon as well as the power of Congress to regulate the courts. These limitations would be unnecessary if the act were in its nature exclusively remedial."

The best explanation of the nature of the Arbitration Act today is contained in a statement of the Second Circuit in *Metro Industrial Painting Corp.* v. *Terminal Construction Co.*, 287 F.2d 382, 386, cert. denied, 368 U. S. 817 (1961):

> "The report submitted by the committee of the House of Representatives which drew up the law expressly found authority for its enactment in the power over federal-court procedures granted to Congress by Article III, §1 of the Constitution and the substantive powers of Article I, §8 (interstate commerce) and Article III, §2 (admiralty). Since the Act could not stand after the Supreme Court decision in *Bernhardt* v. *Polygraphic Co.*, supra, as an exercise of the power to control procedures in the federal courts, the alternative basis of legislative authority became the sole ground for invoking the Act in diversity cases."

If there is any significance to the fact that the Federal Arbitration Act was patterned after the New York statute, it would tend to support a substantive construction. The New York statute has itself been analyzed as "changing the substantive law of arbitration in New York as well as providing a new remedy."[4]

In the subcommittee hearings of the Judiciary Committee in 1928, Senate Bill 4214, virtually the same bill as the one enacted the following year, was discussed. Mr. Charles Bernheimer, then Chairman of the Arbitration Committee of the New York Chamber of Commerce, at whose request the bill was introduced, testified as follows:

> "This bill follows the lines of the New York arbitration law, applying it to the fields wherein there is

4. See 69 Yale L. J. 848, *supra* note 3, at 854-55, for an analysis of the New York Arbitration Act as changing "the substantive nature of arbitration" law in New York.

> Federal jurisdiction. These fields are in admiralty and in foreign and interstate commerce." Hearing Before Subcommittee of the Judiciary on S.4214 (67th Cong. 4th Sess., 1923), p. 2.

Again there is emphasis placed upon the areas of congressional substantive power.

While it was indicated in *dicta* in *Robert Lawrence Co.* v. *Devonshire Fabrics, Inc.*, 271 F.2d 402, 408 (2d Cir. 1959), *cert. granted*, 362 U. S. 909 (1960), *dismissed pursuant to Rule 60*, 364 U. S. 801 (1960), that the Act did not furnish an independent basis of federal jurisdiction, it must also be noted that the purpose in so doing was to further prove the Act's substantive nature. For, as was noted, if the Act were merely procedural, it obviously would not have furnished an independent basis of federal jurisdiction. The fact that the draftsmen took such pains within the Act to so stipulate further supports the conclusion that more than mere procedural regulation was intended. Section 14 of the Act itself reinforces this conclusion. If only a rule of procedure in the federal courts were at issue, there would have been no reason to deny the Act retroactive effect. Instead the Act specifically provided that it was inapplicable to contracts made prior to January 1, 1926.

It is true that there is no intent expressed in the Act that it be directly applicable to state court actions. But, considering the year in which the Act was passed, no inference can be drawn that it was thus not intended to be substantive.

> "The enactment occurred during the era of *Swift* v. *Tyson*, when even with respect to underlying rules of

decision in the commercial field, divergence between state and federal law was not uncommon." Note, 73 Harv. L. Rev. 1382, 1383 (1960).

It should also be noted, that even if a characterization of the Act as purely procedural were correct, Congress nevertheless intended that it apply in interstate commerce cases arising in federal court under diversity of citizenship. For at the time, pre-*Erie* and pre-*Bernhardt*, the appropriate procedural law to be applied was the law of the forum. Despite the fact that the state law which otherwise would have governed the transaction might be one of common-law revocability, the federal forum would apply the federal rule of irrevocability as expressed in the Act. To rule today that in the identical circumstances a state common law rule of revocability would control would necessarily thwart the precise result the Act was intended to accomplish. In 1925, when the law was enacted, only two states enforced agreements to arbitrate future disputes. To suggest that Congress would fashion a modern federal law of enforceability which would in turn enforce "state-created rights" of non-enforceability in forty-six states would be absurd.[5]

While, as has been noted, the Congress of 1925 may not have specifically intended the Act to be applicable in state courts, this is understandable in view of the *Swift* v. *Tyson* era in which the law was enacted. This absence of specific intent is not, however, of particular significance in determin-

5. The research department of the American Arbitration Association has compiled a partial list of 122 organizations which sponsored the Federal Arbitration Law. It must be seriously doubted that they would have had any interest in a law with such a minimal impact. A list of these organizations is included as an Appendix.

ing whether the Act should be held to apply in state courts today.[6]

What is dispositive is that Congress intended a national substantive law of arbitration to govern arbitration provisions in interstate commerce cases.

> "If it is an exercise of the commerce and admiralty powers, the Act must apply not only to litigation in the federal courts but to suits in state courts as well." *Metro Industrial Painting Corp.* v. *Terminal Construction Co.*, 287 F.2d 382, 386 (2d Cir. 1961).[7]

The best statement of the possible alternatives before the Court is well presented in Note, 69 Yale L. J. 847, 864 (1960).

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6. For instance, in *Pennsylvania* v. *Nelson*, 350 U. S. 497, 504 (1956), this Court held that "the conclusion is inescapable that Congress has intended to occupy the field of sedition" and that "a state sedition statute is superseded regardless of whether it purports to supplant the federal law," despite the written opinion of the Smith Act's author, Representative Howard Smith, that Congress never had "the faintest notion of nullifying the concurrent jurisdiction of the respective sovereign states to pursue also their own prosecutions for subversive activities." Quoted in Brief for Petitioner in *Pennsylvania* v. *Nelson* at p. 37.

7. The Sixth Circuit in *American Airlines Inc.* v. *Louisville & Jefferson County Air Board*, 269 F.2d 811 (1959), cited as a case in opposition (pet. brief, p. 13), makes the same point at p. 815.

> "Within the scope of the [United States Arbitration] statute circumscribed by the Constitution, Federal law is of course paramount under the Supremacy Clause, and State law must give way."

For other cases to the same effect, see *Robinson* v. *Bache & Co.*, 227 F.Supp. 456 (S.D. N.Y. 1964); *Younker Bros. Inc.* v. *Standard Constr. Co.*, 241 F.Supp. 17 (S.D. Ia. 1965); and *Coastal States Gas Producing Co.* v. *Producing Properties, Inc.*, 203 F.Supp. 956 (S.D. Tex. 1962).

"Had the 1925 Congress anticipated *Erie*, it seems likely [in light of the argument presented, *amicus* submits that it is conclusive] that it would have preferred making state courts enforce maritime and interstate or foreign commerce arbitration agreements to emasculating the federal act by excluding all diversity suits."

POINT II

Federal Arbitration Law requires arbitration of fraud in the inducement disputes under a broad clause, where the remedy sought is rescission.

A. Intent of the Parties

The first issue to be decided, as in any case where specific performance of an arbitration agreement is sought, is whether the arbitration clause is broad enough to include within it the particular dispute between the parties. For it is in the arbitration clause that the intention to arbitrate must be found. If the clause is too limited to include the dispute, this requisite intent will be lacking, and arbitration will accordingly be denied.

In the case at bar, the parties agreed to arbitrate "any controversy or claim arising out of or relating to this Agreement, or the breach thereof." This very clause (substituting "Contract" for "Agreement") has been, for more than twenty years, Kellor, *American Arbitration* (1948), p. 231, suggested by the American Arbitration Association to parties who wish to take the minimum risk that any dispute later be adjudicated outside the scope of arbitration. This clause, commonly referred to as the broad clause, is

the most all-embracing arbitration clause normally contained in any contract.

As such, its application to this fact situation has been judicially noted, in *dicta,* in *In re Kinoshita & Co.,* 287 F.2d 951, 953 (2d Cir. 1961).

> "Had the parties used the standard clause recommended by the American Arbitration Association and widely used, the arbitration agreement would clearly have been sufficiently broad to cover a dispute over fraudulent inducement."

This statement, based on an interpretation of the same arbitration clause with reference to the same dispute, stands in sharp contrast to the assertion that men would never consciously agree to arbitrate any fraud that would give rise to an action to set aside their agreement (pet. brief, p. 26).

The extent of the parties' agreement is contained in the arbitration clause. To what did they agree? They agreed to arbitrate any controversy or claim arising out of or relating to the agreement. The question is whether this dispute, fraud in the inducement, is a controversy or claim arising out of or relating to the agreement. No amount of rhetoric can further clarify or simplify the meaning of these terms. It is submitted that a reasonable construction of this all-embracing language must compel the conclusion reached in *Kinoshita,* that the instant dispute is encompassed within its scope.

It is submitted that the underlying misconception surrounding this notion of intent is well illustrated in the

statement that "to say that the parties contemplated fraud is specious" (pet. brief, p. 27).

It may well be true that the parties did not contemplate fraud, but only in the sense that they did not contemplate any other *particular* kind of dispute. Indeed, if they had contemplated specific types of disputes, and desired to limit arbitration to those disputes alone, they would not have used the broad clause. They would instead have used a clause narrowly directed to the issues they saw in prospect.[8]

This very distinction between the broad arbitration clause and a restrictive arbitration provision was emphasized within the last month by the Court of Appeals for the District of Columbia in *J. P. Greathouse Steel Erectors, Inc.* v. *Blount Brothers Constr. Co.* (No. 20082, Feb. 8, 1967). At issue was a restrictive clause limiting arbitration to "any question of fact." The court, in holding that the arbitrators exceeded their authority under the clause by arbitrating a claim for breach of contract, made special reference to the fact that the parties had not utilized the broad language suggested by the American Arbitration Association, thus evidencing an intent to limit the arbitrators' power.

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8. "The parties are generally allowed great leeway to frame an arbitration clause which answers their specific needs. In some instances they may find it advisable to use a restrictive clause eliminating the arbitrator's freedom to deal with any issues arising out of the contractual relationship that they do not wish submitted to him. * * * A restrictive clause may provide that the arbitrator can deal only with a specific provision of the contract. * * * They [the parties] may decide to limit arbitration to factual issues only." Domke, *Commercial Arbitration* (Prentice Hall, 1965), pp. 37-38.

The American Arbitration Association is frequently the administrator of arbitrations at the request of parties, run pursuant to arbitration clauses so tailored to include certain disputes and exclude others.[9] In the case at bar, the inclusion of this broad arbitration clause indicates that the parties not only had no contemplation as to the specific type of dispute that would arise, but also did not intend to restrict the use of arbitration to any given area, or exclude its operation in any given area.

The real contention in the case at bar would seem to be that despite the fact that a normal construction of the clause would establish the dispute to be encompassed by the arbitration provision, this provision should nonetheless be viewed as inapplicable to disputes which involve the making of the contract. The asserted reason is that parties would never agree to arbitrate that the agreement itself was fraudulently obtained.

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9. For example, the arbitration provision in the standard uninsured motorist endorsement which accounted for 64% of the 13,000 cases administered in 1966 by the AAA, contains such a narrow clause. "Arbitration. If any person making claim hereunder and the company do not agree that such person is legally entitled to recover damages from the owner or operator of an uninsured automobile because of bodily injury to the insured, or do not agree as to the amount of payment which may be owing under this endorsement, then, upon written demand of either, the matter or matters upon which such person and the company do not agree shall be settled by arbitration in accordance with the rules of the American Arbitration Association, and judgment upon the award rendered by the arbitrators may be entered in any court having jurisdiction thereof. Such person and the company each agree to consider itself bound and to be bound by any award made by the arbitrators pursuant to this endorsement."

Under this clause, only issues involving negligence and the amount of damages are left to arbitration. *Rosenbaum* v. *American Surety Co.*, 11 N. Y. 2d 310, 229 N. Y. S. 2d 375 (1962).

This contention misconstrues the fundamental purpose behind the inclusion of a broad arbitration clause.

As already indicated, when parties are of the opinion that certain types of disputes might be more advantageously resolved through arbitration, but not others, they so provide in a restricted clause. Or if they should agree that an arbitrator would be better suited to determine certain types of issues, such as issues of fact, but not of law, they may so provide, again in a restricted clause.

Underlying the broad clause, however, is the conscious judgment of the parties that resort to a court over any dispute, whatever its type, whatever the issues, is somehow to lose. The reasons for that judgment may be any of several. They may be based on sound pragmatic considerations or a misconception of the legal process. But parties are entitled to make that judgment. For instance, the parties may consider a speedy final decision of disputes of such paramount importance, that, correct or incorrect, it is preferable to one reached through the judicial process with its potentially lengthy and time-consuming appeal procedures. The parties may pre-judge legal fees to be too expensive, whatever the dispute, or universally prefer privacy and/or informality to a court trial. It may simply be that the parties share a mutual dislike for the court system, as many admittedly possess for arbitration. The reasons, so long as they are not themselves fraudulent should be irrelevant.[10] What is relevant is that the parties

10. Thus, there is no disagreement with the statement in *Moseley* v. *Electronic & Missile Facilities, Inc.*, 374 U. S. 167, 83 S. Ct. 1815, 10 L. Ed. 2d 818 (1963) (pet. brief, p. 20), that the question as to whether the arbitration provision *itself* was fraudulently induced is a judicial one.

intended to exclude the judiciary, for reasons which apply equally as well to "fraud in the inducement" disputes as to any others. For a speedy, final resolution of a "fraud in the inducement" dispute can be as much desired as a speedy and final resolution of a dispute over adequacy of performance. This being true, it is submitted that there is no basis to the contention that parties simply do not intend to arbitrate disputes involving fraud in the inducement.

B. Separability

Another issue bearing on this point is whether an arbitration agreement within a container contract is separable. Before this question can be answered, it is necessary to understand why it is relevant.

The argument has been urged, that unless the arbitration clause is treated as separable, a claim that the entire transaction was induced by fraud requires that the arbitration provision necessarily falls with the rest of the contract.

Thus, at least where the remedy applied for is rescission (an action for damages based on the fraud would have the effect of affirming the contract, *including* the arbitration clause) an initial judicial determination is required to determine whether the contract and all its provisions, including the arbitration provision, are valid.

Conversely, if the arbitration clause is viewed as separable, the objection would be avoided, since no taint would attach to the arbitrator's contractual power under the arbitration clause, unless that clause itself was alleged to be fraudulently induced.

It is submitted that the "non-separability" rule cannot be accepted in that it inherently disregards the single fundamental question at issue. Did the parties *intend* that the dispute of fraudulent inducement be arbitrated?

It has been suggested that the parties can easily avoid limiting interpretations of an arbitration clause "by the use of sufficiently explicit language" (pet. brief, p. 22). Paradoxically, however, under a non-separability rule, no clause, no matter how explicit (if a more explicit arbitration clause is possible) could ever be sufficiently explicit to permit arbitration of a fraud in the inducement dispute, if rescission were sought. This for the obvious reason that any such clause must inevitably expose the same defect, namely inclusion within the challenged agreement.

Realistically, what is at issue is whether the broad arbitration clause encompasses a claim of fraud in the inducement, or whether no future disputes clause will be construed as adequate for that purpose. A direct answer to this question is of vital importance to the thousands of commercial businessmen who commonly utilize the clause.

The separability rule, on the other hand, might properly be described as a rule of legal necessity, designed to give effect to the intentions of the parties.

Under this rule, before arbitration can be ordered, a determination must first be made as to whether the parties intended that fraud in the inducement be arbitrated. This is accomplished by an examination of the arbitration provi-

sion.[11] If the clause is not broad enough to evidence that intent, arbitration will not be so ordered, because there is no agreement to arbitrate the particular dispute. If the clause demonstrates the intent of the parties to arbitrate fraud in the inducement, a rule of separability is justified on the basis that the parties themselves must have intended the clause to be separable if they intended it to have effect at all.

Admittedly this cannot be considered any more than a constructive intent. The parties contemplated separability and non-separability as much as they contemplated fraud. The key question is whether they intended to arbitrate fraud in the inducement. A rule of law which first raises that question, and enforces arbitration where that intent is found, is far more reasonable and in conformity with the expectations of the parties than a rule which automatically denies enforcement to the arbitration agreement without any concern for the parties' intent.

There is no merit to the contention that arbitration will destroy a party's inherent right to elect its remedy, in this case rescission.[12]

Section 42 of the Commercial Arbitration Rules of the American Arbitration Association, under which the parties

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11. This analysis is in complete accord with the statement of Brennan, J. and Harlan, J., concurring in *United Steelworkers of America* v. *American Man. Co.*, 363 U. S. 564, 570 (pet. brief, p. 19). Whether the parties have agreed to arbitrate this particular dispute should be the conclusive issue in the case.

12. Further, to permit a party to defeat an arbitration clause merely by later framing his pleadings so as to seek a particular type of relief, in this case, rescission, would do violence to the parties' original contractual intent, which should control.

agreed to arbitrate, specifically provides that "the arbitrator may grant *any* remedy or relief which he deems just and equitable and within the scope of the agreement of the parties * * *." The commercial arbitrator possesses, under American Arbitration Association rules, equitable powers sufficient to grant rescission, if he should find that relief merited.[13]

The remedy which petitioner elects he may obtain at arbitration as well as in court. He loses no right to elect it, but is merely prevented from seeking it in a particular *forum*, in keeping with his agreement.

Conclusion

Amicus is not concerned with the outcome of this case so far as it affects the particular parties. It is seriously concerned with the effect that a decision on the two questions presented would have upon the free and sound progress of the system of commercial arbitration in this country.

It submits that a holding that the Federal Arbitration Act is procedural would herald the renaissance of the old common law hostility to arbitration, which the Act was passed to overcome. As to the meaning to be accorded the broad arbitration clause, *amicus* endorses the view articu-

13. The New York Court of Appeals has confirmed the power of the arbitrator, under AAA rules, to grant equitable relief. "The contract provided that any controversy arising out of it should be settled by arbitration in accordance with American Arbitration Association rules and the rules of that Association in so many words authorized an arbitrator to grant equitable relief." *Staklinski* v. *Pyramid Elec. Co.*, 6 N.Y. 2d 159, 163, 188 N.Y.S.2d 541, 542 (1959).

lated in *Lawrence* that it must be interpreted in light of the Act's liberal policy of promoting arbitration to accord with the original intention of the parties.

Respectfully submitted,

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APPENDIX

Partial List of Organizations Sponsoring the Federal Arbitration Law

1	The Western Fruit Jobbers' Association of America	Chicago, Ill.
2	National Wholesale Grocers' Association	New York, N. Y.
3	San Francisco Chamber of Commerce	San Francisco, Cal.
4	Musical Supply Association	New York, N. Y.
5	Babson Institute	Wellesley Hills, Mass.
6	Sun Maid Raisin Growers (formerly California Association Raisin Co.)	Fresno, Cal.
7	National Poultry, Butter & Egg Association	Chicago, Ill.
8	Chamber of Commerce of Kansas City	Kansas City, Mo.
9	California Peach & Fig Growers	Fresno, Cal.
10	Canners' League of California	San Francisco, Cal.
11	Music Publishers' Protective Association	New York, N. Y.
12	Lake Charles Association of Commerce	Lake Charles, La.
13	Amer. Chamber of Commerce of Philippine Islands	Manila, P. I.
14	North American Fruit Exchange	New York, N. Y.
15	Atlantic Fruit Co.	New York, N. Y.
16	Live Poultry & Dairy Shippers' Traffic Association	Chicago, Ill.
17	Yakima Fruit Growers' Association	Yakima, Wash.
18	Fruit Dispatch Co.	New York, N. Y.
19	American Fruit Growers	Pittsburgh, Pa.
20	California Packing Corporation	San Francisco, Cal.
21	Chamber of Commerce of the State of New York	New York, N. Y.
22	Los Angeles Chamber of Commerce	Los Angeles, Cal.
23	N. Y. Board of Trade and Transportation	New York, N. Y.
24	National League of Commission Merchants of U. S.	Washington, D. C.
25	Converters' Association	New York, N. Y.
26	Philadelphia Association of Credit Men	Philadelphia, Pa.
27	Philadelphia Chamber of Commerce	Philadelphia, Pa.
28	Rochester Association of Credit Men	Rochester, N. Y.
29	Broadway Board of Trade	Brooklyn, N. Y.
30	National Association of Credit Men	New York, N. Y.
31	Crockery Board of Trade of New York	New York, N. Y.
32	Arbitration Society of America	New York, N. Y.
33	International Apple Shippers' Association	Rochester, N. Y.
34	American Manufacturers' Export Association	New York, N. Y.
35	Central Mercantile Asssociation	New York, N. Y.
36	Building Trades Employers' Association of the City of New York	New York, N. Y.
37	Federated Fruit & Vegetable Growers, Inc. (Co-operative, non-profit—National Sales Service)	New York, N. Y.

38	The American Bankers Association	New York, N. Y.
39	Music Industries Chamber of Commerce	New York, N. Y.
40	American Exporters' & Importers' Association	New York, N. Y.
41	The Merchants' Association of New York	New York, N. Y.
42	Tri-Boro Chamber of Commerce	Braddock, Pa.
43	Baton Rouge Chamber of Commerce	Baton Rouge, La.
44	Merchants' and Mfrs.' Association of Baltimore	Baltimore, Md.
45	N. Y. Coffee and Sugar Exchange, Inc.	New York, N. Y.
46	N. Y. State Forestry Association, Inc.	Albany, N. Y.
47	American Fruit and Vegetable Shippers' Association	Chicago, Ill.
48	San Antonio Chamber of Commerce	San Antonio, Tex.
49	New Orleans Association of Commerce	New Orleans, La.
50	Commercial Law League of America	Chicago, Ill.
51	New Jersey State Chamber of Commerce	Newark, N. J.
52	The Albany Chamber of Commerce	Albany, Ga.
53	Chamber of Commerce, Haywood County	Brownsville, Tenn.
54	Portsmouth Chamber of Commerce	Portsmouth, N. H.
55	Chamber of Commerce and Business Men's Club	San Antonio, Tex.
56	The Atlanta Chamber of Commerce	Atlanta, Ga.
57	The Chamber of Commerce	Hazleton, Pa.
58	Hudson County Typothetae	Jersey City, N. J.
59	Association of Commerce (for Jackson and Madison County)	Jackson, Tenn.
60	Chamber of Commerce of Michigan City	Michigan City, Ind.
61	The Rotary Club of Newark, N. J.	Newark, N. J.
62	Massachusetts State Chamber of Commerce	Boston, Mass.
63	Winsted Chamber of Commerce	Winsted, Conn.
64	New Brunswick Board of Trade	New Brunswick, N. J.
65	Chamber of Commerce	Fort Smith, Ark.
66	New Jersey Lumbermen's Association	Newark, N. J.
67	Chamber of Commerce	Houston, Texas
68	Chamber of Commerce	Nashville, Tenn.
69	Bradford Board of Commerce	Bradford, Pa.
70	Sheridan Commercial Club	Sheridan, Wyo.
71	Manistee Board of Commerce	Manistee, Mich.
72	Brooklyn Chamber of Commerce	Brooklyn, N. Y.
73	Grant County Chamber of Commerce	Silver City, N. M.
74	Cincinnati Chamber of Commerce	Cincinnati, Ohio
75	The Produce Club of Chicago	Chicago, Ill.
76	Oklahoma City Chamber of Commerce	Oklahoma City, Okla.
77	The U. & I. Club of Detroit	Detroit, Mich.
78	Parkersburg Board of Commerce	Parkersburg, W. Va.
79	Grand Rapids Fresh Fruit & Vegetable Jobbers	Grand Rapids, Mich.
80	Mobile Chamber of Commerce	Mobile, Ala.
81	Philadelphia Board of Trade	Philadelphia, Pa.
82	Chamber of Commerce	Dubuque, Iowa

83	Philadelphia Maritime Exchange	Philadelphia, Pa.
84	Chamber of Commerce	Fort Wayne, Ind.
85	Board of Trade	Chicago, Ill.
86	Chamber of Commerce	Butte, Mont.
87	Kiwanas Club of Butte	Butte, Mont.
88	Butte Association of Credit Men	Butte, Mont.
89	Butte Rotary Club	Butte, Mont.
90	Spokane Merchants' Association	Spokane, Wash.
91	Helena Commercial Club	Helena, Mont.
92	Southern Arizona Traffic Association	Douglas, Ariz.
93	Kiwanas Club of San Antonio	San Antonio, Tex.
94	Cass County Chamber of Commerce	Logansport, Ind.
95	New Orleans Board of Trade, Ltd.	New Orleans, La.
96	Illinois Fruit Jobbers' Association	Chicago, Ill.
97	St. Louis Chamber of Commerce	St. Louis, Mo.
98	Helena Chamber of Commerce	Helena, Ark.
99	Ft. Worth Chamber of Commerce	Ft. Worth, Ark.
100	Minneapolis Civic and Commerce Association	Minneapolis, Minn.
101	Great Falls Commercial Club	Great Falls, Mont.
102	Chamber of Commerce	Allentown, Pa.
103	Evansville Chamber of Commerce	Evansville, Ind.
104	Silk Association of America	New York, N. Y.
105	Rotary Club of Lafayette	Lafayette, Ind.
106	Cleveland Chamber of Commerce	Cleveland, Ohio
107	Jonesboro Chamber of Commerce	Jonesboro, Ark.
108	The Boosters	Philadelphia, Pa.
109	San Antonio Wholesale Credit Men's Association	San Antonio, Tex.
110	The Fruit and Produce Dealers' Club	Kansas City, Mo.
111	The Merchants' Exchange of St. Louis	St. Louis, Mo.
112	Kansas City Association of Credit Men	Kansas City, Mo.
113	N. Y. Wholesale Grocers' Association	New York, N. Y.
114	Sioux City Chamber of Commerce	Sioux City, Iowa
115	National American Wholesale Lumber Association	New York, N. Y.
116	Knoxville Board of Commerce	Knoxville, Tenn.
117	Lincoln Chamber of Commerce	Lincoln, Neb.
118	Greater Burlington Association	Burlington, Iowa
119	Chamber of Commerce	St. Joseph, Mo.
120	New Haven Chamber of Commerce	New Haven, Conn.
121	Arizona Wholesale Produce Association	Douglas, Ariz.
122	American Farm Bureau Federation	Washington, D. C.

SUPREME COURT, U. S.

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IN THE

Supreme Court of the United States

October Term, 1966

No. 343

PRIMA PAINT CORPORATION,

Petitioner,

against

FLOOD & CONKLIN MFG. CO.,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR PETITIONER

AND

BRIEF FOR PETITIONER IN OPPOSITION TO THE MOTION AND BRIEF OF THE AMERICAN ARBITRATION ASSOCIATION AS *AMICUS CURIAE*

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

No. 343

PRIMA PAINT CORPORATION,

Petitioner,

against

FLOOD & CONKLIN MFG. CO.,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR PETITIONER

Statutes Involved

The statutory provisions involved are printed in petitioner's brief 3-5. While the questions presented touch on this Section as originally passed, it is not readily apparent in petitioner's brief that Section 4 of the Federal Arbitration Act was amended in 1954. For the convenience of the Court, we reprint the applicable portion (Pet. Br. 4) with new matter *italized* and omitted matter [bracketed].

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for arbitration may petition any [court of the] United States *district court* which, save for such agreement, would have jurisdiction under [the judicial code at law, in

equity,] *Title 28, in a civil action* or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement. Five days' notice in writing of such application shall be served upon the party in default. Service thereof shall be made in the manner provided by [law for the service of summons in the jurisdiction in which the proceeding is brought.] *the Federal Rules of Civil Procedure.* The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. The hearing and proceedings, under such agreement, shall be within the district in which the petition for an order directing such arbitration is filed. If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof. If no jury trial be demanded by the party alleged to be in default, or if the matter in dispute is within admiralty jurisdiction, the court shall hear and determine such issue. Where such an issue is raised, the party alleged to be in default may, except in cases of admiralty, on or before the return day of the notice of application, demand a jury trial of such issue, and upon such demand the court shall make an order referring the issue or issues to a jury in the manner provided by [law for referring to a jury issues in an equity action,] *the Federal Rules of Civil Procedure* or may

Statement of the Case

F & C's "statement" is replete with gross misstatements, artfully contrived distortions, and unwarranted assumptions, which are wholly without this Record, completely unsupported, obviously self-serving, and contradicted by Prima.

Demonstrative of respondent's impropriety is its bold presentation for the first time of a question never raised below and contrary to the rules of this Court. (Rule 40(1)(d), Point IV, *infra*).

The misstatements are exemplified by the following:

A. "Prima was aware of this filing and of the subsequent progress of the Chapter XI proceeding" (Resp. Br. 3).

B. "Prima in fact made no complaint to F & C or to any of its representatives during the pendency of the Chapter XI proceeding" (Resp. Br. 3).

C. "Prima continued * * * to avail itself of such advisory and consultative services as it desired without a hint of any grievance" (Resp. Br. 3).

D. "Prima continued, without complaint, its use of F & C's consulting services and customer lists" (Resp. Br. 4).

E. "Only on September 17, 1965 did Prima complain" (Resp. Br. 4).

F. "The complaint does not allege * * * nor does the Record anywhere indicate, that F & C's Chapter XI proceeding * * * prevented F & C from performing any of its undertakings * * *" (Resp. Br. 5-6).

G. "* * * F. & C was asked to and did actually perform its consulting function * * *" (Resp. Br. 6).

H. "* * * No claim of 'fraud' was raised by Prima until a year after the supposed fraud was perpetrated" (Resp. Br. 6).

I. "F & C is * * * no nearer to resolution of the controversy created by Prima" (Resp. Br. 8).

A hearing below would have developed that Prima was never a creditor of F & C, received no bankruptcy notices, and therefore could only have been aware of such subsequent proceedings as actual knowledge on its part can be shown, and that Prima sought relief in the Bankruptcy Court as early as February 19, 1965. Some of Prima's grievances with respect thereto were in fact communicated to F & C (R. 28-30). F & C's performance of its consulting function is wholly unsupported by the Record, except for a self-serving statement contained in Paragraph 8 of the affidavit of F & C's attorney (R. 17), who obviously never had, nor could have had any personal knowledge of what occurred during the Receiver's administration.

Finally, any resolution of which party created this controversy still remains an undetermined question of fact.

F & C's statement is rife with speculations, distortions and assumptions, and by the posing of factual issues admittedly establishes the necessity of a hearing, as illustrated below:

J. "Presumably, Prima intends * * * the nine other breaches * * * will be resolved by arbitration" (Resp. Br. 6).

K. "Prima * * * continued * * * to avail itself of the consulting services of Mr. Jelin" (Resp. Br. 7).

L. "Prima was obviously not prejudiced * * * *" (Resp. Br. 7).

M. "In none of the papers * * * did it (Prima) attempt to explain how F & C's financial condition was in any way material * * * *" (Resp. Br. 6).

After reversal and remand of this matter, these barren allegations will be dissipated with dispatch.

POINT I

The instant agreement does not evidence a transaction involving interstate commerce.

F & C admits that:

> "Prima's reliance, perforce, was on the customer lists, on the agreement of F & C not to compete, and on the availability of Jerome K. Jelin to render consulting services." (Resp. Br. 6)

The customer lists, were to be used solely for the computation of payments for F & C's employment (Consulting Agreement, Par. 4(a), R. 22). The agreement was merely one of employment between the parties, with the usual covenant not to compete. Not by any stretch of the imagination, can this be considered a contract evidencing a transaction in interstate commerce.

Prima's president is quoted as stating that the agreement "contemplated and intended an orderly transfer of the assets * * * of" F & C (Resp. Br. 14, R. 40-41). This

statement does not concede the transaction involved interstate commerce. The reference to "assets" can only mean those set forth in the agreement in dispute herein, that is, expertise and know-how (advice and consultation) and a covenant not to compete.

This agreement does not evidence a transaction in interstate commerce for all of the reasons set forth above and in Point I of petitioner's main brief.

POINT II

Congress has not created a federal right to arbitration.

No emasculation of the Federal Arbitration Act can occur by excising diversity cases from its ambit as suggested by F & C (Resp. Br. 19). Further, this court's ultimate decision, as it may affect, forum, validity of contract, and law applicable thereto, cannot possibly be characterized as an unjustifiable interference with the proper exercise of commerce powers (Resp. Br. 20).

There is no express or implied language of pre-emption of state rights set forth in the Act. Moreover, the Act does not meet any tests of "conflict", "coincidence" or "preclusion" heretofore applied as determinative by this Court in such cases (60 Harv. L. Rev. 262 (1946).

F & C's argument and its resulting legal effect (Resp. Br., Point I(B)) is contrary to all precedent as set forth in Point II of petitioner's main brief and petitioner's brief in opposition to the *Amicus, infra,* to which this Court is respectfully referred.

POINT III

Interpretation and effect of the Federal Arbitration Act is a question of state law.

Prima refutes F & C's contentions as set forth in Point II of its brief (Resp. Br. 21) and relies upon its argument in Point III of the petitioner's main brief and petitioner's brief in opposition to the *Amicus, infra.*

POINT IV

Rescission for fraudulent inducement is not referable to arbitration.

F & C admits, that as a threshold question, *Robert Lawrence* requires judicial determination of fraud in the inception of the contract (Point II, Resp. Br. 23-24).

F & C's authorities are all distinguishable both on the law and the facts. Those which are worthy of comment follow:

Neither, *Amerotron Corp.* v. *Maxwell Shapiro Woolen Co.*, 3 A. D. 2d 899, 162 N. Y. S. 2d 214 (1st Dept. 1957), *aff'd w/o opinion*, 4 N. Y. 2d 722, 148 N. E. 2d 319 (1958); nor *M. W. Kellogg Co.* v. *Monsanto Chemical Co.*, 9 A. D. 2d 744, 192 N. Y. S. 2d 869 (1st Dept. 1959); nor *Fabrex Corporation* v. *Winard Sales Company*, 23 Misc. 2d 26, 200 N. Y. S. 2d 278 (Sup. Ct. Spec. T., N. Y. Co. 1960); were found to be actions for rescission of contract for fraudulent inducement.

Amerotron was an action for *damages for fraud* (an action affirming the contract). *Kellogg* was an action for fraudulent *misrepresentation in the contract* (an action on contract). *Fabrex* involved a question of *performance of contract* (an action on contract).

Rodgers, et al. v. *Feldman & Lambeth Management Inc.*, 65 Civ. 1413, S. D. N. Y., August 24, 1965, Wyatt, J. (not officially reported, printed *infra*, Appendix A) sets forth present New York law, *unchanged* since *Robert Lawrence*. Judge Wyatt further found that the holding of *Fabrex*, cited by the Court of Appeals in the case at bar (R. 49), is either distinguishable or wrong.

The issue in *Nelley* v. *Baltimore City*, 224 Md. 1, 166 A. 2d 234 (1960), was resolved as a question of election. Finding that the plaintiff elected to finish the contract, the Court held this "latter remedy was the one actually and clearly chosen, and is, of course, an affirmance of the contract". In agreeing with *Amerotron*, as to whether the fraud alleged was arbitrable, the Maryland Court clearly presupposed that an election to affirm the contract had occurred.

The Court recognized that *Robert Lawrence* goes beyond *Amerotron*:

> "• • • for it reaches this conclusion notwithstanding disaffirmance of the contract by the party claiming to have been defrauded. That, we repeat, is not the situation before us. Patapsco clearly elected to affirm the contract and to seek damages for alleged concealment or misrepresentation in its inducement

> • • • it thus ratified both the substantive contract and the arbitration procedure which it embodied." *Nelley* v. *Baltimore City*, 166 A. 2d 234, 240 (1960).

This universal principle was recognized by Massachusetts in *Maxwell Shapiro Woolen Co.* v. *Amerotron Corp.*, 339 Mass. 252, 158 N. E. 2d 875, 879 (1959), when it held:

> "Shapiro has not sought to rescind the contracts, so we are not concerned with the effect of rescission upon arbitration."

It is readily apparent that the cases cited by F & C are non-authoritative, do not support its argument, and overwhelmingly support the position of Prima that rescission for fraudulent inducement is not referable to arbitration.

POINT V

The election of a remedy or a cause of action is legally determinative of validity, irrevocability and enforceability of an agreement.

The F & C characterization (Point III (B), Resp. Br. 28) as proper, of the Court below's erroneous finding of lack of distinction between equitable rescission and damages at law on contract, is entirely without merit. Negation thereof, regardless of the grossness of the fraud perpetrated, will result in complete abdication of judicial supervision, and shut the Courthouse door to the defrauded party.

Each and every relevant case cited in all the briefs reveal a meticulous examination into the cause of action asserted, in order to determine whether the action is in the nature of an affirmance of contract or whether it seeks rescission or repudiation of an agreement.

While a similar argument was rejected in *Robert Lawrence,* the result (not its holding) was proper, in view of the fact that the cause of action set forth in the complaint was *damages* for fraud in the inducement of the contract (Appendix 2-3, Docket No. 25209, Court of Appeals, 2d Cir.). Such an averment is in fact an affirmance of a contract. Additionally, the parties admitted in their briefs, that a *federal right* was involved.

It is noteworthy that, Judge Medina's theory, relied on by F & C (Resp. B- 29), is barren and devoid of reference or citation to any legal precedents.

This Court cannot fail to recognize, nor can it overlook an accepted and time-honored principle, that fraud permeates an entire agreement. This Court, in affirming the decision below and the *Robert Lawrence* doctrine, would be putting its imprimatur on a policy which would permit the judiciary, without legislative sanction, to abolish and obliterate common law causes of action (election of remedies) in diversity cases, obviously violative of Constitutional authority and the principals of *Erie* and its progeny.

POINT VI

Problems of restoration will not defeat equitable rescission.

Prima's claim for rescission is equitable in nature, and there is no requirement that Prima tender restoration prior to commencement of an action for equitable rescission. The extent to which Prima might be required to make restoration, as a condition to rescission, are questions to be determined at a hearing, not upon this review.

In *Marr* v. *Tumulty*, 256 N. Y. 15, 175 N. E. 356 (1931) the New York Court of Appeals (per Cardozo, C. J.) held that a complaint for rescission in equity was not defective because it did not embody an adequate tender of restoration. The Court observed that:

> "Equity is not crippled at such times by an inexorable formula. In exacting the return of benefits as a condition of rescission it proportions the exaction to the justice of the case before it. * * *
>
> * * * A different situation would be here if the action were at law upon the basis of a rescission already effectively declared. Instead, it is in equity to procure the declaration of a decision on whatever terms may be just (*Buffalo Builders Supply Co.* v. *Reeb, supra; Allerton* v. *Allerton*, 50 N. Y. 670; *Vail* v. *Reynolds*, 118 N. Y. 297, 302; *Thomas* v. *Beals*, 154 Mass. 51). Suitable conditions may be imposed by the decree (*Thomas* v. *Beals, supra; Allerton* v. *Allerton, supra;* American Law Inst. Restatement, Contracts, §98A)" (256 N. Y. at 21, 22).

And in *William Whitman Co.* v. *Universal Oil Products Co.*, 125 F. Supp. 137 (D. Del. 1954), a claim for equitable rescission was allowed even though specific restoration was impossible.

> "• • • rescission on the ground of fraud will not be denied because the exact benefits and advantages received by the defrauded party cannot, by reason of their nature, be restored, but the equities of the matter and justice to the parties will be moulded by the decree" (125 F. Supp. at 161-2).

F & C (Resp. Br. 33-34) relies upon *Lummus Company* v. *Commonwealth Oil Refining Co.*, 280 F. 2d 915 (1st Cir. 1960), *cert. denied* 364 U. S. 911 (1960) which had been decided only after lengthy hearings below (280 F. 2d at 930). In any event, we submit that *Lummus*, far from supporting F & C's position, stands for a contrary proposition and is inapposite. In the first instance, *Lummus* admittedly criticized *Robert Lawrence*, and its proposition was succinctly stated:

> "We hold that unless, by means of a proper claim for rescission, Commonwealth has put in issue the 'making of the contract,' it cannot by merely asserting fraud, stay the arbitration proceedings.
>
> • • • The principal thrust of the complaint • • • appears to be a tort action for damages" (280 F. 2d at 927).

It is abundantly clear therefore, that equity will mold its decree so that barren allegations concerning problems of restoration will not defeat equitable rescission.

POINT VII

This Court should wholly disregard F & C's Point IV.

A. F & C Raises a *de Novo* Argument

F & C urges this Court to affirm the order below alleging, first, Prima waived its right to rescind, and second, Prima never substantively demonstrated its claim of fraud below.

These arguments are entirely without the Record, are in violation of Supreme Court Rule 40 (1) (d) and are mere afterthoughts. This Court should not permit such arguments since they were never raised in any Court below, nor are they presented in the questions upon which certiorari was granted.

This Court has consistently refused to consider questions not raised or passed upon in the Courts below, (*Lawn* v. *United States*, 355 U. S. 339, 362, 2 L. Ed. 2d 321, 337, 78 S. Ct. 311 (1958); *Duignan* v. *United States*, 274 U. S. 195, 200, 71 L. Ed. 996, 1000, 47 S. Ct. 566 (1927), or mentioned in the petition for certiorari (*J. I. Case Co.* v. *Borak*, 377 U. S. 426, 12 L. Ed. 2d 423, 84 S. Ct. 1555 (1964); *Ryan* v. *United States*, 379 U. S. 61, 13 L. Ed. 2d 122, 85 S. Ct. 232 (1964); *Beck* v. *Washington*, 369 U. S. 541, 8 L. Ed. 2d 98, 109, 82 S. Ct. 955 (1962); cf. *Irvine* v. *California*, 347 U. S. 128, 98 L. Ed. 561, 74 S. Ct. 381 (1953).

The proceedings below conclusively establish that F & C continually relied upon, and the Courts below uniformly applied, the *Lawrence* theory of separability and concluded

as a *matter of federal law,* that issues of fraud, *regardless* of merit or substance, were referable to arbitration.

B. Respondent's Argument in Point IV Is Wholly Without Merit

F & C's legal precedents (Resp. Br. 35) asserted as determinative of its *de novo* argument, that prior to granting injunctive relief irreparable injury and reasonable probability of success must be shown, is completely inapposite. Without exception, the cases cited, involve actions under the Anti-Trust Acts, based upon 15 U. S. C. Section 26, which specifically requires such a demonstration.

Prima's original motion for a stay of arbitration was made pursuant to the Federal Rules of Civil Procedure which does not impose identical requirements.

1. No Waiver Was Committed by Prima

The Court should disregard F & C's assertion of waiver on Prima's part.

This plea, by way of confession and avoidance, was never raised below. Thus in effect, F & C now admits fraud had been perpetrated, but seeks to avoid its resulting legal impact. In assuming the burden of proving affirmative acts, F & C argues, that certain acts attributable to Prima are of sufficient magnitude to prevent Prima's election of the remedy of equitable rescission.

In every case cited by F & C (Resp. Br. 38) the party against whom waiver was successfully asserted had engaged in voluntary *affirmative acts,* thereby affirming the contracts.

F & C's newly formed theory of waiver is founded upon Prima's alleged *passive* "behavior in remaining silent" (Resp. Br. 37). To set forth Prima's contradictions would unnecessarily belabor this issue (Pet. Reply Br. 1-3, *supra*).

2. *Prima's Allegations Are Meritorious*

F & C maintained from the onset of these proceedings that the issue of fraud, *meritorious or otherwise,* is an issue referable to arbitration and not subject to preliminary judicial determination by the District Court. It would be an anomaly to allow F & C to argue that all issues of fraud are arbitrable and permit it the effrontery to suggest, indeed argue at length affirmatively, that Prima was not put to its proof of fraud below. F & C, through this apparent innovation and thin contrivance, belatedly seeks to argue a lack of substance to Prima's allegations of fraud. We submit these were and are issues the District Court should have determined upon a hearing.

CONCLUSION

For all of the reasons set forth herein and in the petitioner's main brief, it is respectfully submitted that the judgment of the court below be reversed.

Dated: New York, N. Y.
March 10, 1967

Robert P. Herzog,
Attorney for Petitioner,
Prima Paint Corporation.

Of Counsel:

Jules Teitelbaum,
Grace L. Brodsky.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

No. 343

PRIMA PAINT CORPORATION,

Petitioner,

against

FLOOD & CONKLIN MFG. CO.,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR PETITIONER IN OPPOSITION TO THE MOTION AND BRIEF OF THE AMERICAN ARBITRATION ASSOCIATION AS *AMICUS CURIAE*

POINT I

The Federal Arbitration Act was enacted by Congress based upon powers granted by Article III, Section I, of the Constitution.

The American Arbitration Association, which submitted a brief as *Amicus Curiae*, (hereinafter referred to as

"*Amicus*") and Prima agree that one of the traditional methods employed to answer a question of legislative basis for congressional enactments is to ascertain the *intent* of the framers of the legislation.

Contrary to the *Amicus* claim (*Amicus* Br. 4) there is sufficient historical background available to conclusively establish that the framers intended this Act to be merely procedural in its application and remedial in its scope.[1] The dearth, if any, is the almost complete absence of all reference to intended substantive effect.

Julius Henry Cohen, one of the leading authorities on Commercial Arbitration and a member of the American Bar Association Committee, sponsoring this legislation, at that time wrote "that enforcement of arbitration contracts is within the *law of procedure* as distinguished from substantive law is well established."[2] Further support that the legislative basis was Article III of the Constitution can be inferentially derived from the fact that the legislation originated in the Judiciary Committee of both Houses. References to interstate commerce and admiralty were evidently used to buttress the legislation,[3] since it

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[1] H. R. Rep. No. 96, 68 Cong., 1st Sess. (1924); S. Rep. No. 536, 68 Cong. 1st Sess. (1924); *American Airlines Inc.* v. *Country Air Board*, 269 F. 2d 811, 816 (6t Cir. 1959).

[2] Cohen & Dayton, The New Federal Arbitration Law, 12 Va. L. Rev. 266, 276 (1926) (Emphasis supplied).

[3] "Thus, despite criticism by commentators of the *Red Cross* case for its characterization of arbitration, congressional reliance on it in 1925 reflected the understanding that the Act was to regulate procedure in the federal courts, even though the commerce clause was relied on to buttress the Article III legislative base." Note 73 Harv. L. Rev. 1382, 1383 (1960).

is admitted that Congress has no power to legislate upon the validity of contracts generally. *Agostini Bros. Bldg. Corp.* v. *United States*, 142 F. 2d 854, 856 (4th Cir. 1944).

Bernhardt v. *Polygraphic Co. of America, Inc.*, 350 U. S. 198, 76 S. Ct. 273, 100 L. Ed. 199 (1956) does not support a proposition that the Federal Arbitration Act is substantive in its scope or application. *Bernhardt* clearly and admittedly *avoided such a holding* to escape the Constitutional problem it would have presented (350 U. S. at 202). To the contrary, the *Bernhardt* Court stated that "§§1 and 2 *define* the field in which Congress was legislating" (350 U. S. at 201, emphasis supplied). This holding that §2 is definitional in scope forecloses any possible consideration that §2 can have substantive application.

The *Bernhardt* Court characterized arbitration as a "remedy" and the Act as a "rule of procedure", in a case apart from the Federal Act (350 U. S. at 202, 203). No forceful reasons have been presented by Prima's opponents to require changing this characterization in a case within the Act.

It is patently clear that the *Bernhardt* decision was grounded upon the Constitutional limitation of *Erie*.[4] The *Bernhardt* view, that §3 unless restricted "would invade the local law field" manifests the conclusion that §2 would abuse and controvert this principle, if the position suggested by the *Amicus* were sustained.

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[4] "that Congress does not have the Constitutional authority to make the law that is applicable to controversies in diversity of citizenship cases." (350 U. S. at 202)

The *Amicus* disposes of the Constitutional question raised in Justice Frankfurter's concurring opinion in *Bernhardt* by casually claiming it would be non-existent if this Court characterizes §2 as substantive (*Amicus* Br. 6). Such a suggestion is erroneous.

Ever since *Guaranty Trust Co.* v. *York*, 326 U. S. 99, 65 S. Ct. 1465, 89 L. Ed. 2079 (1945), this Court has steadfastly followed a proposition that in a diversity case, any conflict between state and federal, law and policy, which will "significantly affect the result of a litigation" must be resolved in favor of state law and policy (326 U. S. at 109). To therefore label this Act substantive will not suffice to dispel the Constitutional problem remaining, whether the outcome of litigation of contracts containing an arbitration agreement will depend upon the Courthouse in which the action has been instituted, unless state law and policy is deemed to control the validity of such agreements.

Mere secondary authority supports the *Amicus* proposition that the New York Statute has been analyzed as "changing the substantive law of arbitration in New York as well as providing a new remedy" (*Amicus* Br. 8, n. 4). Conversely, the New York cases cited by Prima (Pet Br. 17) are the controlling precedents on this subject.

The *Amicus*, in an effort to find a substantive intent on the part of the Act's framers, relies upon a comment made in a sub-committee hearing, held fully two years before the Bill's passage (*Amicus* Br. 8-9). The *Amicus* omits those statements made in the Congressional Record and in the House and Senate reports [5] at the time of the Bill's

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[5] See note 1 *supra*; 65 Cong. Rec. 1931 (1924).

passage which clearly indicate that the Act was intended to be procedural, and the feeling of contemporary writers that such was the legislative intent.[6]

The damaging *dicta* of Judge Medina in the *Robert Lawrence* case, that the Act did not furnish an independent basis of federal jurisdiction, is inverted by the *Amicus* who by sheer sophistry concludes that it proves the Act's substantive nature (*Amicus* Br. 9). The irrefutable denial by Judge Medina of a substantive application of the Act, contrasted with the inductive sleight-of-hand applied by the *Amicus*, cannot compel a conclusion that the Act was meant to be substantive.

Desperately the *Amicus*, seeking to reinforce this mystical reasoning, seizes upon a single sentence[7] which fixes the effective date and denies retroactive effect to the Act, declaring that "If only a rule of procedure in the federal courts were at issue, there would have been no reason to deny the Act retroactive effect" (*Amicus* Br. 9). Rule 86 of the Federal Rules of Civil Procedure rebuts this thesis since it, in substance, also denies retroactive effect to the Federal Rules of Civil Procedure.

A specious rationale is then conjured by the *Amicus* that no permissible inference can be drawn from the complete absence of any expressed intent in the Act that it be applicable to state court actions (*Amicus* Br. 9). Moreover, the *Amicus* urges that this absence of a specific intent is not of particular significance (*Amicus* Br. 10).

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[6] See note 9, Petitioner's main brief.

[7] 9 U. S. C. §14.

It is axiomatic that silence as well as expression may be determinative of legislative intent. This admitted Congressional silence is susceptible of a single inference, that is, lack of intent to make the act applicable to state court actions.

For the reasons stated, the conclusion is inescapable, that §2 of the Arbitration Act must be held procedural in its application when jurisdiction is founded *solely* upon diversity of the parties.

POINT II

An arbitration clause in a contract does not exist as a separable special agreement and a question of fraud in the inducement, challenging the validity of the entire contract, must be determined in the first instance judicially.

Prima and the *Amicus* agree that the first issue to be determined is the contractual intent of the parties. From this point on, the reasoning of Prima and the *Amicus* depart.

The *Amicus* claims that Prima misconstrues the purpose underlying the inclusion of a broad arbitration clause, because such a clause indicates a "conscious judgment" of the parties to arbitrate (*Amicus* Br. 16). The fallacy inherent in this hypothesis is that the existence of fraud in the inducement of a contract contradicts the supposition of any conscious act, even to arbitrate. Such an allegation negates in the first instance any meeting of the minds. To fortify this faulty premise, the *Amicus* neces-

sarily requires that the Judiciary reject the concept of the integral nature of a contract.

The imposition of the *Amicus'* so-called "rule of legal necessity" will defeat any judicial test of the alleged "conscious judgment" of the parties (*Amicus* Br. 16-18). Once a party is duped into signing a contract which includes a broad arbitration clause, arbitration will follow regardless of the grossness of the fraud perpetrated. See *Mosley* v. *Electronic & Missile Facilities, Inc.*, 375 U. S. 167, 84 S. Ct. 1815, 10 L. Ed. 2d 818 (1963).

In admitting that "It may well be true that the parties did not contemplate fraud", the *Amicus* loses sight that "any other particular kind of dispute" refers to disputes which usually *arise out of* or *concern* the contract (*Amicus* Br. 14). Fraud, however, denies the entire contract's very existence.

Notwithstanding the *Amicus'* contention that a commercial arbitrator possesses power to grant rescission, this Court has, in *Bernhardt* already ruled positively, forcefully, and without contradiction that:

> "The change from a court of law to an arbitration panel may make a radical difference in ultimate result. Arbitration carries no right to trial by jury that is guaranteed both by the Seventh Amendment and by Ch. 1, Art. 12th of the Vermont Constitution. Arbitrators do not have the benefit of judicial instruction on the law; they need not give their reasons for their results; the record of their proceedings is not as complete as it is in a court trial; and judicial review of an award is more limited than judicial review of a trial—all as discussed in Wilko v Swan,

346 US 427, 435-438, 98 L ed 168, 175-177, 74 S Ct 182." (350 U.S. at 203).

A different outcome may result if Prima is relegated to arbitrate the question of fraud in the inducement. Arbitration is different than a trial before a court, therefore it is facetious to argue that there is no resultant loss of remedy, since Prima, as stated in *Bernhardt* will lose "an important part of the parcel of rights" that are behind its election (350 U. S. at 203). Forbidding Prima access to a court of law results in the destruction of its inherent right to elect a remedy.

To impose a requirement of preliminary judicial determination, which §4 of the Act itself provides, can hardly constitute emasculation of the Arbitration Act nor can it herald the renaissance of the old common law hostility to arbitration. Surely judicial determination of the validity of agreements was meant to be preserved by the framers of this legislation.

CONCLUSION

For all of the reasons set forth herein and in the petitioner's main brief, it is respectfully submitted that the judgment of the court below be reversed.

Dated: New York, N. Y.
March 10, 1967

ROBERT P. HERZOG,
Attorney for Petitioner
Prima Paint Corporation.

Of Counsel:
JULES TEITELBAUM,
GRACE L. BRODSKY.

APPENDIX A

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

65 Civ. 1413

SHERWIN ROBERT RODGERS, and SHERWIN ROBERT RODGERS ASSOCIATES, INC., an Illinois Corporation,

Plaintiffs,

against

LAWRENCE FELDMAN and LARBETH MANAGEMENT, INC., a New York Corporation,

Defendants.

APPEARANCES:

PHILIP HANDELMAN, ESQ.,
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360 Lexington Avenue,
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LAWRENCE M. POWERS, ESQ.,
Of Counsel.

LAURENCE FELDMAN, ESQ.,
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1545 Broadway,
New York, N. Y. 10036.

WYATT, District Judge.

Appendix A

This is a motion by plaintiffs to stay arbitration demanded by defendants under a written contract dated February 26, 1965.

Plaintiffs commenced this action on May 10, 1965 seeking (1) damages suffered by plaintiffs because of an alleged fraudulent scheme in violation of the Securities Act of 1933 and the Securities Exchange Act of 1934; and (2) rescission of the February 26, 1965 contract on the ground that plaintiffs were fraudulently induced to make that contract by "material misstatements of fact and * * * misleading omissions of fact" of defendants (Complaint para. 3).

The prayer for relief in the complaint does not in terms demand rescission but it is clear that the position of plaintiffs is that they have already rescinded for fraud and are entitled to have back the $21,000 claimed to have been given up by them or that they are entitled to rescission in this action. Demand for rescission is in para. 11 of the complaint.

Jurisdiction of this Court is based on (1) a federal question (28 U. S. C. §1331) and (2) diversity of citizenship between the parties (28 U. S. C. §1332). The amount in controversy exceeds $10,000.

Copies of the February 26, 1965 contract are attached to the complaint and to the moving affidavit.

Paragraph 15 of the contract is as follows:

> "In the event of any dispute or disagreement between the parties hereto which they are unable to

amicably resolve, the same shall be submitted to arbitration by the American Arbitration Association of New York, New York City pursuant to the rules of said association. The decision of an arbitrator or arbitrators designated by said association shall be final, binding and conclusive upon the parties hereto."

On May 14, 1965, three days after levies had been made under an attachment granted in this action, the American Arbitration Association at New York received a demand for arbitration by the defendants.

The theories for the movants in seeking a stay of arbitration are (1) "a suit based upon the Federal securities statutes may not be stayed to compel a plaintiff to submit his claim of fraud in the inducement to arbitration" on the authority of *Wilko* v. *Swann*, 346 U. S. 427 (1953); and (2) under New York law, applicable to that part of the action seeking rescission of the contract, fraud in the inducement is not an issue to be arbitrated under an arbitration clause in the contract sought to be rescinded.

Without passing on the first theory, it seems clear that the second theory is sound and that the motion must be granted.

In testing the second theory, New York law applies (and not federal law) because the claim to rescission is based on diversity jurisdiction and the parties appear to agree that there is not involved a "maritime transaction or a contract • • • involving commerce" (9 U. S. C. §2). See *Robert*

Appendix A

Lawrence Co. v. *Devonshire Fabrics, Inc.*, 271 F. 2d 402, 404-408 (2d Cir. 1959), cert. dismissed 364 U. S. 801 (1960).

Under Civil Practice Law & Rules ("CPLR") §7503(b) of New York, a party may apply to stay arbitration on the ground that "a valid agreement was not made". A New York court will stay arbitration where rescission of the contract containing the arbitration clause has been sought on the ground that fraud induced the making of the contract.

Professor Corbin states the principle in this way:

> "The fraud of one party, inducing the other's assent to the whole [contract] makes the whole [contract] voidable at the latter's option; after a proper avoidance, the right to an arbitration falls along with all other rights created by the other promises that were made. In cases within this paragraph, the remedies for enforcement of arbitration agreements are not available, including the enforcing order authorized by an arbitration statute. Before issuing such an order the court must know that a legal duty to arbitrate exists; this is an issue that the court itself must decide." 6A Corbin on Contracts §1444, p. 449 (1962).

In *Robert Lawrence Co.*, above cited, Judge Medina found that New York law was in accord with the foregoing quotation but that federal law under the Federal Arbitration Act differed from New York law (271 F. 2d at 412). According to Judge Medina, the agreement to arbitrate clause is (under federal law) to be considered

as separate and apart from the rest of the contract and arbitration may be stayed only where there is a substantial claim that "this arbitration clause was induced by fraud" (271 F. 2d at 402). See 6A Corbin, above, pp. 465-66. The Court in *Robert Lawrence Co.* found as a fact that the arbitration clause—considered apart from the rest of the contract—was not induced by fraud.

Decisions by the Court of Appeals of New York do not separately consider the arbitration clause and the rest of the contract in determining the effect of fraud in the inducement upon the right to arbitration or to a stay of arbitration.

In *Wrap-Vertiser Corp.* v. *Plotnick*, 3 N. Y. 2d 17 (1957), Plotnick and Wrap-Vertiser Corp. ("Wrap") made a distribution contract under which Wrap was to supply equipment and supplies for sale by Plotnick, who when the contract was executed paid $6,000 to Wrap as an advance against deliveries to be made. The contract made arbitration compulsory for any question "as to the validity, interpretation or performance of this agreement". Disputes arose, Plotnick claiming to be the injured party by reason of failure of Wrap to supply good equipment and of fraud by Wrap inducing the agreement, such fraud being misrepresentations as to the products involved, the past experience of Wrap, and ownership by Wrap of a certain patent. Plotnick demanded arbitration of his claims. Wrap then moved the New York Court to stay arbitration of the claim of fraud in the inducement. A

Appendix A

Majority of the Court of Appeals decided that such a stay was proper because the issue of fraud in the inducement was not within the terms of the arbitration clause—was not a question "as to the validity, interpretation or performance of this agreement". The three dissenting justices believed that the fraud issue was within the language of the arbitration clause. The decision and this difference between the judges (which are of no significance in the case at bar) came about because (unlike the case here) Plotnick was *not* asking *rescission* of the contract but was standing on the contract. As to this, the majority declared (3 N. Y. 2d at 19, 20):

> "He [Plotnick] has not rescinded nor does he seek rescission either alone or in conjunction with damages. He has elected to affirm the contract and bases his contentions upon its binding force, as Justice Botein's dissenting opinion states at the Appellate Division. If he were seeking rescission, none of the items in his arbitration demand could be arbitrated until the issue of rescission had been determined in the courts. * * * No question of validity of the contract is at stake inasmuch as Plotnick has chosen to stand upon the agreement and does not seek rescission. Even if he had rescinded or asked for rescission, such an issue would have had to have been decided in court before it could be known that an agreement existed supplying a foundation for the jurisdiction of the arbitrators."

Nothing in the dissent disputed the principle stated in the quoted language of the majority. While dicta, the lan-

guage reflects the unanimous view of the Court of Appeals that where rescission for fraud is demanded, as in the case at bar, such fraud issue may not be arbitrated.

An arbitration clause much broader than in *Wrap-Vertiser* was before the courts in a case cited for defendants—*Amerotron Corp.* v. *Maxwell Shapiro Woolen Co., Inc.*, 3 A. D. 2d 899 (1st Dept. 1957), affirmed 4 N. Y. 2d 722 (1958). The fraud claim was within the *broad terms* of the arbitration clause and thus arbitration could not be denied, as had been done in *Wrap-Vertiser*, because of the wording of the arbitration clause. Arbitration of the fraud claim was held proper. The decision is no authority whatever for defendants since in *Amerotron*, like *Wrap-Vertiser* but unlike the case at bar, rescission had not been demanded. The point was carefully noted: "* * * respondent failed to rescind the contract and elected to recognize the contract and claim damages for the fraud" (3 A. D. 2d at 899).

Judge Fuld later stated the policy of New York to be that "where parties enter into an agreement and, in one of its provisions, promise that any dispute arising out of or in connection with it shall be settled by arbitration, any controversy which arises between them and is within the compass of the provision must go to arbitration." *Exercycle Corp.* v. *Maratta*, 9 N. Y. 2d 329, 334 (1961). He then made plain that such a case as that at bar fell outside this policy. "As exceptions to this general policy, however, we have held that a court will enjoin arbitra-

tion • • • where fraud or duress, practiced against one of the parties, rendered the agreement voidable • • •" (9 N. Y. 2d at 334). Of course, Judge Fuld meant that arbitration in such cases would be enjoined *if* the party claiming to be defrauded had demanded rescission; as we have seen, if the injured party elects to stand on the agreement he may not at the same time enjoin enforcement of an arbitration clause in that agreement.

It remains to notice *Fabrex Corp.* v. *Winard Sales Co.*, 200 N. Y. S. 2d 278 (Special Term, N. Y. County, 1960), cited for defendants. The decision might be distinguished on the ground that the fraud there claimed was not an inducement for the agreements but "relates solely to the question of performance under the contracts" (200 N. Y. S. 2d at 280). If not so distinguishable, then the decision must be considered, with great deference, to be wrong.

For the reasons indicated, the motion is granted and the arbitration demanded by defendants under the contract of February 26, 1965, is hereby stayed pending final determination of this action.

So Ordered.

Dated: New York, New York
August 24, 1965

Inzer B. Wyatt
United States District Judge

SUPREME COURT OF THE UNITED STATES

No. 343.—October Term, 1966.

Prima Paint Corporation, Petitioner, v. Flood & Conklin Mfg. Co.	On Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

[June 12, 1967.]

Mr. Justice Fortas delivered the opinion of the Court.

This case presents the question whether the federal court or an arbitrator is to resolve a claim of "fraud in the inducement," under a contract governed by the Federal Arbitration Act of 1925,[1] where there is no evidence that the contracting parties intended to withhold that issue from arbitration.

The question arises from the following set of facts. On October 7, 1964, respondent Flood & Conklin Manufacturing Company, a New Jersey corporation, entered into what was styled a "Consulting Agreement," with petitioner Prima Paint Corporation, a Maryland corporation. This agreement followed by less than three weeks the execution of a contract pursuant to which Prima Paint purchased F & C's paint business. The consulting agreement provided that for a six-year period F & C was to furnish advice and consultation "in connection with the formulae, manufacturing operations, sales and servicing of Prima Trade Sales accounts." These services were to be performed personally by F & C's chairman, Jerome K. Jelin, "except in the event of his death or disability." F & C bound itself for the duration of the contractual period to make no "Trade Sales" of paint or paint products in its existing sales territory or to current customers. To the consulting agreement were appended lists of F & C customers, whose patronage was to be taken over by

[1] 43 Stat. 883, as amended, 61 Stat. 669. 9 U. S. C. §§ 1–14.

Prima Paint. In return for these lists, the covenant not to compete, and the services of Mr. Jelin, Prima Paint agreed to pay F & C certain percentages of its receipts from the listed customers and from all others, such payments not to exceed $225,000 over the life of the agreement. The agreement took into account the possibility that Prima Paint might encounter financial difficulties, including bankruptcy, but no corresponding reference was made to possible financial problems which might be encountered by F & C. The agreement stated that it "embodies the entire understanding of the parties on the subject matter." Finally, the parties agreed to a broad arbitration clause, which read in part:

> "Any controversy or claim arising out of or relating to this agreement, or the breach thereof, shall be settled by arbitration in the City of New York in accordance with the rules then obtaining of the American Arbitration Association . . . ."

The first payment by Prima Paint to F & C under the consulting agreement was due on September 1, 1965. None was made on that date. Seventeen days later, Prima Paint did pay the appropriate amount, but into escrow. It notified attorneys for F & C that, in various enumerated respects their client had broken both the consulting agreement and the earlier purchase agreement. Prima Paint's principal contention, so far as presently relevant, was that F & C had fraudulently represented that it was solvent and able to perform its contractual obligations, whereas it was in fact insolvent and intended to file a petition under Chapter XI of the Bankruptcy Act shortly after execution of the consulting agreement. Prima Paint noted that such a petition was filed by F & C on October 14, 1964, one week after the contract had been signed. F & C's response, on October 25, was to serve a "notice of intention to arbitrate." On November 12,

three days before expiration of its time to answer this "notice," Prima Paint filed suit in the United States District Court for the Southern District of New York, seeking rescission of the consulting agreement on the basis of the alleged fraudulent inducement.[2] The complaint asserted that the federal court had diversity jurisdiction.

Contemporaneously with the filing of its complaint, Prima Paint petitioned the District Court for an order enjoining F & C from proceeding with the arbitration. F & C cross-moved to stay the court action pending arbitration. F & C contended that the issue presented—whether there was fraud in the inducement of the consulting agreement—was a question for the arbitrators and not for the District Court. Cross-affidavits were filed on the merits. On behalf of Prima Paint, the charges in the complaint were reiterated. Affiants for F & C attacked the sufficiency of Prima Paint's allegations of fraud, denied that misrepresentations had been made during negotiations, and asserted that Prima Paint had relied exclusively upon delivery of the lists, the promise not to compete, and the availability of Mr. Jelin. They contended that Prima Paint had availed itself of these considerations for nearly a year without claiming "fraud," noting that Prima Paint was in no position to claim ignorance of the bankruptcy proceeding since it had participated therein in February of 1965. They added that F & C was revested with its assets in March of 1965.

The District Court granted F & C's motion to stay the action pending arbitration, holding that a charge of

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[2] Although the letter to F & C's attorneys had alleged breaches of both consulting and purchasing agreements, and the fraudulent inducement of both, the complaint did not refer to the earlier purchase agreement, alleging only that Prima Paint had been "fraudulently induced to accelerate the execution and closing of the [consulting] agreement from October 21, 1964, to October 7, 1964 . . . ."

fraud in the inducement of a contract containing an arbitration clause as broad as this one was a question for the arbitrators and not for the court. For this proposition it relied on *Robert Lawrence Co.* v. *Devonshire Fabrics, Inc.*, 271 F. 2d 402 (C. A. 2d Cir. 1959), cert. granted, 362 U. S. 909, dismissed under Rule 60, 364 U. S. 801 (1960). The Court of Appeals for the Second Circuit dismissed Prima Paint's appeal. It held that the contract in question evidenced a transaction involving interstate commerce; that under the controlling *Robert Lawrence Co.* decision a claim of fraud in the inducement of the contract generally—as opposed to the arbitration clause itself—is for the arbitrators and not for the courts; and that this rule—one of "national substantive law"—governs even in the face of a contrary state rule.[3] We agree, albeit for somewhat different reasons, and we affirm the decision below.

The key statutory provisions are §§ 2, 3, and 4 of the Federal Arbitration Act of 1925. Section 2 provides that a written provision for arbitration "in any maritime transaction or a contract evidencing a transaction involving commerce . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."[4] Section 3 requires a federal court in which suit has been brought "upon any issue referable to arbitration upon an agreement in

[3] Whether a party seeking *rescission* of a contract on the ground of fraudulent inducement may in New York obtain judicial resolution of his claim is not entirely clear. Compare *Exercycle Corp.* v. *Maratta*, 9 N. Y. 2d 329, 334 (1961), and *Amerotron Corp.* v. *Maxwell Shapiro Woolen Co.*, 3 App. Div. 2d 889 (1st Dept. 1957), aff'd, 4 N. Y. 2d 722 (1958), with *Fabrex Corp.* v. *Winard Sales Co.*, 200 N. Y. S. 2d 278 (N. Y. Co. 1960). In light of our disposition of this case, we need not decide the status of the issue under New York law.

[4] The meaning of "maritime transaction" and "commerce" is defined in § 1 of the Act.

writing for such arbitration" to stay the court action pending arbitration once it is satisfied that the issue is arbitrable under the agreement. Section 4 provides a federal remedy for a party "aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement of arbitration," and directs the federal court to order arbitration once it is satisfied that an agreement for arbitration has been made and has not been honored.[5]

In *Bernhardt* v. *Polygraphic Co.*, 350 U. S. 198 (1956), this Court held that the stay provisions of § 3, invoked here by respondent F & C, apply only to the two kinds of contracts specified in §§ 1 and 2 of the Act, namely those in admiralty or evidencing transactions in "commerce." Our first question, then, is whether the consulting agreement between F & C and Prima Paint is such a contract. We agree with the Court of Appeals that it is. Prima Paint acquired a New Jersey paint business serving at least 175 wholesale clients in a number of States, and secured F & C's assistance in arranging the transfer of manufacturing and selling operations from New Jersey to Maryland.[6] The consulting agree-

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[5] See, *infra*, pp. —.

[6] This conclusion is amply supported by an affidavit submitted to the District Court by Prima Paint's own president, which read in part:

"This agreement entered into between the parties on October 7, 1964, contemplated and intended an orderly transfer of the assets of the defendant to the plaintiff, and further contemplated that the defendant would consult, advise, assist and help the plaintiffs so as to insure a smooth transition of manufacturing operations to Maryland from New Jersey, together with the sales and servicing of customer accounts and the retention of the said customers."

The affidavit's references to a "transfer of assets" cannot fairly be read to mean only "expertise and know-how . . . and a covenant not to compete," as argued by counsel for petitioner.

ment was inextricably tied to this interstate transfer and to the continuing operations of an interstate manufacturing and wholesaling business. There could not be a clearer case of a contract evidencing a transaction in interstate commerce.[7]

Having determined that the contract in question is within the coverage of the Arbitration Act, we turn to the central issue in this case: whether a claim of fraud in the inducement of the entire contract is to be resolved by the federal court, or whether the matter is to be referred to the arbitrators. The Courts of Appeals have differed in their approach to this question. The view of the Court of Appeals for the Second Circuit, as expressed in this case and in others[8] is that—*except where the*

[7] It is suggested in dissent that, despite the absence of any language in the statute so indicating, we should construe it to apply only to "contracts between merchants for the interstate shipment of goods." Not only have we neither the desire nor the warrant so to amend the statute, but we find persuasive and authoritative evidence of a contrary legislative intent. See, *e. g.*, the House Report on this legislation which proclaims that "the control over interstate commerce [one of the bases for the legislation] reaches not only the actual physical interstate shipment of goods but also contracts related to interstate commerce. H. R. Rep. No. 96, 68th Cong., 1st Sess., 1 (1924). We note, too, that were the dissent's curious narrowing of the statute correct, there would have been no necessity for Congress to have amended the statute to exclude certain kinds of employment contracts. See § 1. In any event, the anomaly urged upon us in dissent is manifested by the present case. It would be remarkable to say that a contract for the purchase of a single can of paint may evidence a transaction in interstate commerce, but that an agreement relating to the facilitation of the purchase of an entire interstate paint business and its re-establishment and operation in another State is not.

[8] In addition to *Robert Lawrence Co., supra*, see *In re Kinoshita & Co.*, 287 F. 2d 951 (C. A. 2d Cir. 1961). With respect to claims other than fraud in the inducement, the court has followed a similar process of analysis. See, *e. g., Metro Industrial Painting Corp. v. Terminal Const. Co.*, 287 F. 2d 382 (C. A. 2d Cir. 1961) (dispute

parties otherwise intend—arbitration clauses as a matter of federal law are "separable" from the contracts in which they are embedded, and that where no claim is made that fraud was directed to the arbitration clause itself, a broad arbitration clause will be held to encompass arbitration of the claim that the contract itself was induced by fraud.[9] The Court of Appeals for the First Circuit, on the other hand, has taken the view that the question of "severability" is one of state law, and that where a State regards such a clause as inseparable a claim of fraud in the inducement must be decided by the court. *Lummus Co.* v. *Commonwealth Oil Ref. Co.*, 280 F. 2d 915, 923–924 (C. A. 1st Cir.), cert. denied, 364 U. S. 911 (1960).[10]

With respect to cases brought in federal court involving maritime contracts or those evidencing transactions in "commerce," we think that Congress has provided an explicit answer. That answer is to be found in § 4 of the Act, which provides a remedy to a party seeking to compel compliance with an arbitration agreement. Under §4, with respect to a matter within the jurisdiction of the federal courts save for the existence of an arbitration clause, the federal court is instructed to order

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over performance); *El Hoss Engineer. & Transport Co.* v. *American Ind. Oil Co.*, 289 F. 2d 346 (C. A. 2d Cir, 1961) (where, however, the court found an intent not to submit the issue in question to arbitration).

[9] The Court of Appeals has been careful to honor evidence that the parties intended to withhold such issues from the arbitrators and to reserve them for judicial resolution. See *El Hoss Engineer. & Transport Co.* v. *American Ind. Oil Co.*, *supra*. We note that categories of contracts otherwise within the Arbitration Act but in which one of the parties characteristically has little bargaining power are expressly excluded from the reach of the Act. See § 1.

[10] These cases and others are discussed in a recent note, Commercial Arbitration in the Federal Courts, 20 Vand. L. Rev. 607, 622–625 (1967).

arbitration to proceed once it is satisfied that "the making of the agreement for arbitration or the failure to comply [with the arbitration agreement] is not in issue:" [11] Accordingly, if the claim is fraud in the inducement of the arbitration clause itself—an issue which goes to the "making" of the agreement to arbitrate—the federal court may proceed to adjudicate it.[12] But the statutory language does not permit the federal court to consider claims of fraud in the inducement of the contract generally. Section 4 does not expressly relate to situations like the present in which a stay is sought of a federal action in order that arbitration may proceed. But it is inconceivable that Congress intended the rule to differ depending upon which party to the arbitration agreement first invokes the assistance of a federal court. We hold, therefore, that in passing upon a § 3 application for a stay while the parties arbitrate, a federal court may consider only issues relating to the making and performance of the agreement to arbitrate. In so concluding, we not only honor the plain meaning of the statute but also the unmistakably clear congressional

[11] Section 4 reads in part: "The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. . . . If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof."

[12] This position is consistent both with the decision in *Moseley* v. *Electronic Facilities*, 374 U. S. 167, 171, 172 (1963), and with the statutory scheme. As the "saving clause" in § 2 indicates, the purpose of Congress in 1925 was to make arbitration agreements as enforceable as other contracts, but not more so. To immunize an arbitration agreement from judicial challenge on the ground of fraud in the inducement would be to elevate it over other forms of contract—a situation inconsistent with the "saving clause."

purpose that the arbitration procedure, when selected by the parties to a contract, be speedy and not subject to delay and obstruction in the courts.

There remains the question whether such a rule is constitutionally permissible. The point is made that, whatever the nature of the contract involved here, this case is in federal court solely by reason of diversity of citizenship, and that since the decision in *Erie R. Co.* v. *Tompkins*, 304 U. S. 64 (1938), federal courts are bound in diversity cases to follow state rules of decision in matters which are "substantive" rather than "procedural," or where the matter is "outcome determinative." *Guaranty Trust Co.* v. *York*, 326 U. S. 99 (1945). The question in this case, however, is not whether Congress may fashion federal substantive rules to govern questions arising in simple diversity cases. See *Bernhardt* v. *Polygraphic Co., supra,* at 202 and at 208. Rather, the question is whether Congress may prescribe how federal courts are to conduct themselves with respect to subject matter over which Congress plainly has power to legislate. The answer to that can only be in the affirmative. And it is clear beyond dispute that the federal arbitration statute is based upon and confined to the incontestable federal foundations of "control over interstate commerce and over admiralty." H. R. Rep. No. 96, 68th Cong., 1st Sess., 1 (1924); S. Rep. No. 536, 68th Cong., 1st Sess., 3 (1924).[13]

[13] It is true that the Arbitration Act was passed 13 years before this Court's decision in *Erie R. Co.* v. *Tompkins, supra,* brought to an end the regime of *Swift* v. *Tyson*, 16 Pet. 1 (1842), and that at the time of enactment Congress had reason to believe that it still had power to create federal rules to govern questions of "general law" arising in simple diversity cases—at least, absent any state statute to the contrary. If Congress relied at all on this "oft-challenged" power, see *Erie R. Co.*, 304 U. S., at 69, it was only supplementary to the admiralty and commerce powers, which formed

In the present case no claim has been advanced by Prima Paint that F & C fraudulently induced it to enter into the agreement to arbitrate "any controversy or claim arising out of or relating to this agreement, or the breach thereof." This contractual language is easily broad enough to encompass Prima Paint's claim that both execution and acceleration of the consulting agreement itself

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the principal bases of the legislation. Indeed, Congressman Graham, the bill's sponsor in the House, told his colleagues that it "only affects contracts relating to interstate subjects and contracts in admiralty." 65th Cong. Rec. 1931 (1924). The Senate Report on this legislation similarly indicated that the bill "[relates] to maritime transactions and to contracts in interstate and foreign commerce." S. Rep. No. 536, 68th Cong., 1st Sess., 3 (1924).

Non-congressional sponsors of the legislation agreed. As Mr. Charles L. Bernheimer, chairman of the Arbitration Committee of the New York Chamber of Commerce, told the Senate subcommittee, the proposed legislation "follows the lines of the New York arbitration law, applying it to the fields wherein there is federal jurisdiction. These fields are in admiralty and in foreign and interstate commerce." Hearings on S. 4213 and S. 4214, before the Subcommittee of the Senate Committee on the Judiciary, 67th Cong., 4th Sess., 2 (1923). In the joint House and Senate hearings, Mr. Bernheimer answered "Yes, entirely," to the statement of the chairman, Senator Sterling, that "What you have in mind is that this proposed legislation relates to contracts arising in interstate commerce." Joint Hearings before the Subcommittee of the Committee on the Judiciary, 68th Cong., 1st Sess., 7 (1924). Mr. Julius Henry Cohen, draftsman for the American Bar Association of the proposed bill, said the sponsor's goals were: "[F]irst . . . to get a State statute, *and then to get a federal law to cover interstate and Foreign commerce and admiralty*, and, third, to get a treaty with Foreign countries." Joint Hearings, *supra*, at 16 (emphasis added). See also Joint Hearings, *supra*, at 27–28 (statement of Mr. Alexander Rose). Mr. Cohen did submit a brief to the Subcommittee urging a jurisdictional base broader than the commerce and admiralty powers, Joint Hearings, *supra*, at 37–38, but there is no indication in the statute or in the legislative history that this invitation to go beyond those powers was adopted, and his own testimony took a much narrower tack.

were procured by fraud. Indeed, no claim is made that Prima Paint ever intended that "legal" issues relating to the contract be excluded from arbitration, or that it was not entirely free so to contract. Federal courts are bound to apply rules enacted by Congress with respect to matters—here, a contract involving commerce—over which it has legislative power. The question which Prima Paint requested the District Court to adjudicate preliminarily to allowing arbitration to proceed is one not intended by Congress to delay the granting of a § 3 stay. Accordingly, the decision below dismissing Prima Paint's appeal is

Affirmed.

MR. JUSTICE HARLAN: In joining the Court's opinion I desire to note that I would also affirm the judgment below on the basis of *Robert Lawrence Co.* v. *Devonshire Fabrics, Inc.*, 271 F. 2d 402 (C. A. 2d Cir. 1959), cert. granted, 362 U. S. 909, dismissed under Rule 60, 364 U. S. 801 (1960).

SUPREME COURT OF THE UNITED STATES

No. 343.—October Term, 1966.

Prima Paint Corporation, Petitioner, *v.* Flood & Conklin Mfg. Co.	On Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

[June 12, 1967.]

Mr. Justice Black, with whom Mr. Justice Douglas and Mr. Justice Stewart join, dissenting.

The Court here holds that the Federal Arbitration Act, as a matter of federal substantive law, compels a party to a contract containing a written arbitration provision to carry out his "arbitration agreement" even though a court might, after a fair trial, hold the entire contract—including the arbitration agreement—void because of fraud in the inducement. The Court holds, what is to me fantastic, that the legal issue of a contract's voidness because of fraud is to be decided by persons designated to arbitrate factual controversies arising out of a valid contract between the parties. And the arbitrators the Court holds are to adjudicate the legal validity of the contract need not even be lawyers, and in all probability will be nonlawyers, wholly unqualified to decide legal issues, and even if qualified to apply the law, not bound to do so. I am by no means sure that thus forcing a person to forgo his opportunity to try his legal issues in the courts where, unlike in arbitration, he may have a jury trial and right to appeal, is not a denial of due process of law. I am satisfied, however, that Congress did not impose any such procedures in the Arbitration Act. And I am fully satisfied that a reasonable and fair reading of that Act's language and history shows that both Congress and the framers of the Act were at great pains to emphasize that nonlawyers

designated to adjust and arbitrate factual controversies arising out of valid contracts would not trespass upon the courts' prerogative to decide the legal question of whether any legal contract exists upon which to base an arbitration.

I.

The agreement involved here is a consulting agreement in which Flood & Conklin agreed to perform certain services for and not to compete with Prima Paint. The agreement contained an arbitration clause providing that "any controversy or claim arising out of or relating to this agreement . . . shall be settled by arbitration in the City of New York." F & C, contending that Prima had failed to make a payment under the contract, sent Prima a "Notice of Intention to Arbitrate" pursuant to the New York Arbitration Act.[1] Invoking diversity jurisdiction, Prima brought this action in federal district court to rescind the entire consulting agreement on the ground of fraud. The fraud allegedly consisted of F & C's misrepresentation at the time the contract was made, that it was solvent and able to perform the agreement, while in fact it was completely insolvent. Prima alleged that it would not have made any contract at all with F & C but for this misrepresentation. Prima simply contended that there was never a meeting of minds between the parties. F & C moved to stay Prima's lawsuit for rescession pending arbitration of the fraud issue raised by Prima. The lower courts, relying on the Second Circuit's decision in *Robert Lawrence Co.* v.

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[1] N. Y. Civ. Prac. § 7503 (1963) provides that once a party is served with a notice of intention to arbitrate, "unless the party served applies to stay the arbitration within ten days after such service he shall thereafter be precluded from objecting that a valid agreement was not made . . . ."

Devonshire Fabrics, Inc., 271 F. 2d 402, cert. granted, 362 U. S. 909, dismissed, 364 U. S. 801, held that, as a matter of "national substantive law," the arbitration clause in the contract is "separable" from the rest of the contract and that allegations that go to the validity of the contract in general, as opposed to the arbitration clause in particular, are to be decided by the arbitrator, not the court.

The Court today affirms this holding for three reasons, none of which is supported by the language or history of the Arbitration Act. First, the Court holds that because the consulting agreement was intended to supplement a separate contract for the interstate transfer of assets, it is itself a "contract evidencing a transaction involving commerce," the language used by Congress to describe contracts the Act was designed to cover. But in light of the legislative history which indicates that the Act was to have a limited application to contracts between merchants for the interstate shipment of goods,[2] and in light of the express failure of Congress to use language

[2] The principal support for the Act came from trade associations dealing in groceries and other perishables and from commercial and mercantile groups in the major trading centers. 50 A. B. A. Rep. 357 (1925). Practically all who testified in support of the bill before the Senate subcommittee in 1923 explained that the bill was designed to cover contracts between people in different States who produced, shipped, bought, or sold commodities. Hearings on S. 4214 before the Subcommittee of the Senate Committee on the Judiciary, 67th Cong., 4th Sess., 3, 7, 9, 10 (1923). The same views were expressed in the 1924 hearings. When Senator Sterling suggested, "What you have in mind is that this proposed legislation relates to contracts arising in interstate commerce," Mr. Bernheimer, a chief exponent of the bill, replied: "Yes; entirely. The farmer who will sell his carload of potatoes, from Wyoming, to a dealer in the State of New Jersey, for instance." Joint Hearings on S. 1005 and H. R. 646 before the Subcommittees of the Committees on the Judiciary, 68th Cong., 1st Sess., 7. See also *id.*, at 27.

making the Act applicable to all contracts which "affect commerce," the statutory language Congress normally uses when it wishes to exercise its full powers over commerce,[3] I am not at all certain that the Act was intended to apply to this consulting agreement. Second, the Court holds that the language of § 4 of the Act provides an "explicit answer" to the question of whether the arbitration clause is "separable" from the rest of the contract in which it is contained. Section 4 merely provides that the court must order arbitration if it is "satisfied that the making of the agreement for arbitration . . . is not in issue." That language, considered alone, far from providing an "explicit answer," merely poses the further question of what kind of allegations put the making of the arbitration agreement in issue. Since both the lower courts assumed that but for the Federal Act, New York law might apply and that under New York law a general allegation of fraud in the inducement puts into issue the making of the agreement to arbitrate (considered insep-

[3] In some Acts Congress uses broad language and defines commerce to include even that which "affects" commerce. Federal Employers' Liability Act, 45 U. S. C. § 51; National Labor Relations Act, 29 U. S. C. § 152 (7). In other instances Congress has chosen more restrictive language. Fair Labor Standards Act, 29 U. S. C. § 206. Prior to this case, this Court has always made careful inquiry to assure itself that it is applying a statute with the coverage that Congress intended, so that the meaning *in that statute* of "commerce" will be neither expanded nor contracted. The Arbitration Act is an example of carefully limited language. It covers only those contracts "involving commerce," and nowhere is there a suggestion that it is meant to extend to contracts "affecting commerce." The Act not only uses narrow language, but is also completely without any declaration of some national interest to be served or some nationwide comprehensive scheme of regulation to be created, and this absence suggests that Congress did not intend to exert its full power over commerce.

arable under New York law from the rest of the contract),[4] the Court necesssarily holds that federal law determines whether certain allegations put the making of the arbitration agreement in issue. And the Court approves the Second Circuit's fashioning of a federal separability rule which overrides state law to the contrary. The Court thus holds that the Arbitration Act, designed to provide merely a procedural remedy which would not interfere with state substantive law, authorizes federal courts to fashion a federal rule to make arbitration clauses "separable" and valid. And the Court approves a rule which is not only contrary to state law, but contrary to the intention of the parties and to accepted principles of contract law—a rule which indeed elevates arbitration provisions above all other contractual provisions. As the Court recognizes, that result was clearly not intended by Congress. Finally, the Court summarily disposes of the *Erie* problem, recognized as a serious constitutional problem in *Bernhardt* v. *Polygraphic Co.*, 350 U. S. 198, by insufficiently supported assertions that it is "clear beyond dispute" that Congress based the Arbitration Act on its power to regulate commerce and that "if Congress relied at all on" its power to create federal law for diversity cases, such reliance "was only supplementary."

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[4] Although F & C requested arbitration pursuant to New York law, n. 1, *supra*, it is not entirely clear that New York law would apply in absence of the Federal Act. And, as the Court points out, it is not entirely clear whether New York courts would consider Prima's promise to arbitrate inseparable from the rest of the contract. But, since *Robert Lawrence* held and the lower courts here assumed that application of New York law would produce a different result, and since the Court deems the status of state law as immaterial to this case, I have assumed throughout this opinion that, in the absence of the Arbitration Act, Prima would have been able to obtain *judicial* resolution of its fraud allegations under New York law.

II.

Let us look briefly at the language of the Arbitration Act itself as Congress passed it. Section 2, the key provision of the Act, provides that "a written provision in . . . a contract involving commerce to settle by arbitration a controversy thereafter arising out of such contract . . . shall be valid, irrevocable, and enforceable, *save upon such grounds as exist at law or in equity for the revocation of any contract.*" (Emphasis added.) Section 3 provides that "[i]f any suit . . . be brought . . . *upon any issue referable to arbitration* under an agreement in writing for such arbitration, the court . . . *upon being satisfied that the issue in such suit . . . is referable to arbitration under such agreement,* shall . . . stay the trial of the action until such arbitration has been had . . . ." (Emphasis added.)[5] The language of these sections could not, I think, raise doubts about their meaning except to someone anxious to find doubts. They simply mean this: an arbitration agreement is to be enforced by a federal court unless the court, not the arbitrator, finds grounds "at law or in equity for the revocation of any contract." Fraud, of course, is one of the most common grounds for revoking a contract. If the contract was procured by fraud, then, unless the defrauded party elects to affirm it, there is absolutely no contract, nothing to be arbitrated. Sections 2 and 3 of the Act assume the existence of a valid contract. They merely provide for enforcement where such a valid contract

[5] This section, unlike § 4, is expressly applicable to situations like the present one where a defendant in a case already pending in federal court moves for a stay of the lawsuit. In finding an "explicit answer" in a provision "not expressly" applicable, the Court almost completely ignores the language of § 3 and the proviso to § 2, a section which *Bernhardt* held to "define the field in which Congress was legislating." 350 U. S., at 201.

exists. These provisions were plainly designed to protect a person against whom arbitration is sought to be enforced from having to submit his legal issues as to validity of the contract to the arbitrator. The legislative history of the Act makes this clear. Senator Walsh of Montana, in hearings on the bill in 1923, observed, "The court has got to hear and determine whether there is an agreement of arbitration, undoubtedly, and it is open to all defenses, equitable and legal, that would have existed at law . . . ."[6] Mr. Piatt, who represented the American Bar Association which drafted and supported the Act, was even more explicit: "I think this will operate something like an injunction process, except where he would attack it on the ground of fraud."[7] And then Senator Walsh replied: "If he should attack it on the ground of fraud, *to rescind the whole thing*. . . . I presume that it merely [is] a question of whether he did make the arbitration agreement or not, . . . and then he would possibly set up that he was misled about the contract and entered into it by mistake. . . . ."[8] It is evident that Senator Walsh was referring to situations in which the validity of the entire contract is called into question. And Mr. Bernheimer, who represented one of the chambers of commerce in favor of the bill, assured the Senate subcommittee that "[t]he constitutional right to jury trial is adequately safeguarded" by the Act.[9] Mr. Cohen assured the members of Congress that the Act would not impair the right to a jury trial, because it deprives a person of that right only when he has voluntarily and validly waived it by agreeing to submit cer-

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[6] Senate Hearings, *supra*, at 5.
[7] *Ibid.*
[8] *Ibid.*
[9] Senate Hearings, *supra*, at 2.

tain disputes to arbitration.[10] The court and a jury are to determine both the legal existence and scope of such an agreement. The members of Congress revealed an acute awareness of this problem. On several occasions they expressed opposition to a law which would enforce even a valid arbitration provision contained in a contract between parties of unequal bargaining power. Senator Walsh cited insurance, employment, construction, and shipping contracts as routinely containing arbitration clauses and being offered on a take-it-or-leave-it basis to captive customers or employees.[11] He noted that such contracts "are really not voluntarily [*sic*] things at all" because "there is nothing for the man to do except to sign it; and then he surrenders his right to have his case tried by the court . . . ."[12] He was emphatically assured by the supporters of the bill that it was not their intention to cover such cases. The significant thing is that Senator Walsh was not thinking in terms of the arbitration provisions being "separable" parts of such contracts, parts which should be enforced without regard to why the entire contracts in which they were contained were agreed to. The issue for him was not whether an arbitration provision in a contract was made, but why, in the context of the entire contract and the circum-

[10] "The one constitutional provision we have got is that you have a right of trial by jury. But you can waive that. And you can do that in advance. Ah, but the question whether you waive it or not depends on whether that is your signature to the paper, or whether you authorized that signature, or whether the paper is a valid paper or not, whether it was delivered properly. So there is a question there which you have not waived the right of trial by jury on." Joint Hearings, *supra*, at 17.

It seems quite clear to me that Mr. Cohen was referring to a jury trial of allegations challenging the validity of the *entire* contract.

[11] Senate Hearings, *supra*, at 9–11. See also Joint Hearings, *supra*, at 15.

[12] *Id.*, at 9.

stances of the parties, the entire contract was made. That is precisely the issue that a general allegation of fraud in the inducement raises: Prima contended that it would not have executed any contract, including the arbitration clause, if it were not for the fraudulent representations of F & C. Prima's agreement to an arbitration clause in a contract obtained by fraud was no more "voluntary" than an insured's or employee's agreement to an arbitration clause in a contract obtained by superior bargaining power.

Finally, it is clear to me from the bill's sponsors' understanding of the function of arbitration that they never intended for the issue of fraud in the inducement to be resolved by arbitration. They recognized two special values of arbitration: (1) the expertise of an arbitrator to decide factual questions in regard to the day-to-day performance of contractual obligations,[13] and (2) the speed with which arbitration, as contrasted to litigation, could resolve disputes over performance of contracts and thus mitigate the damages and allow the parties to continue performance under the contracts.[14] Arbitration serves neither of these functions where a contract is sought to be rescinded on the ground of fraud. On the one hand, courts have far more expertise in resolving legal issues which go to the validity of a contract than

[13] "Not all questions arising out of contracts ought to be arbitrated. It is a remedy peculiarly suited to the disposition of the ordinary disputes between merchants as to questions of fact—quantity, quality, time of delivery, compliance with terms of payment, excuses for non-performance, and the like. It has a place also in the determination of the simpler questions of law—the questions of law which arise out of these daily relations between merchants as to the passage of title, the existence of warranties, or the questions of law which are complementary to the questions of fact which we have just mentioned." Cohen & Dayton, The New Federal Arbitration Law, 12 Va. L. Rev. 265, 281 (1926).

[14] See, *e. g.*, Senate Hearings, *supra*, at 3.

do arbitrators.[15] On the other hand, where a party seeks to rescind a contract and his allegation of fraud in the inducement is true, an arbitrator's speedy remedy of this wrong should never result in resumption of performance under the contract. And if the contract were not procured by fraud, the court, under the summary trial procedures provided by the Act, may determine with little delay that arbitration must proceed. The only advantage of submitting the issue of fraud to arbitration is for the arbitrators. Their compensation corresponds to the volume of arbitration they perform. If they determine that a contract is void because of fraud, there is nothing further for them to arbitrate. I think it raises serious questions of due process to submit to an arbitrator an issue which will determine his compensation. *Tumey* v. *Ohio*, 273 U. S. 510.

III.

With such statutory language and legislative history, one can well wonder what is the basis for the Court's surprising departure from the Act's clear statement which expressly excepts from arbitration "such grounds as exist at law or equity for the revocation of any contract." Credit for the creation of a rationalization to justify this statutory mutilation apparently must go to the Second Circuit's opinion in *Robert Lawrence* v. *Devonshire Fabrics, Inc.*, *supra*. In that decision Judge Medina undertook to resolve the serious constitutional problem which this Court had avoided in *Bernhardt* by holding the Act inapplicable to a diversity case involving an intrastate contract. That problem was whether the Arbitra-

[15] "It [arbitration] is not a proper remedy for . . . questions with which the arbitrators have no particular experience and which are better left to the determination of skilled judges with a background of legal experience and established systems of law." Cohen & Dayton, *supra*, at 281.

tion Act, passed 13 years prior to *Erie* v. *Tompkins*, 304 U. S. 64, could be constitutionally applied in a diversity case even though its application would require the federal court to enforce an agreement to arbitrate which the state court across the street would not enforce. *Bernhardt*'s holding that arbitration is "outcome determinative," 350 U. S., at 203, and its recognition that there would be unconstitutional discrimination if an arbitration agreement were enforceable in federal court but not in the state court, *id.*, at 204, posed a choice of two alternatives for Judge Medina. If he held that the Arbitration Act rested solely on Congress' power, widely recognized in 1925 but negated in *Erie*, to prescribe general federal law applicable in diversity cases, he would be compelled to hold the Act unconstitutional as applied to diversity cases under *Erie* and *Bernhardt*.[16] If he held that the Act rested on Congress' power to enact substantive law governing interstate commerce, then the *Erie-Bernhardt* problem would be avoided and the application of the Act to diversity cases involving commerce could be saved.

The difficulty in choosing between these two alternatives was that neither, quite contrary to the Court's position, was "clear beyond dispute" upon reference to the Act's legislative history.[17] As to the first, it is clear that Congress intended the Act to be applicable in diversity cases involving interstate commerce and maritime

[16] Mr. Justice Frankfurter chose this alternative in his concurring opinion in *Bernhardt*, 350 U. S., at 208, and even the Court there suggested that its pre-*Erie* decision in *Shanferoke Coal & Supply Co.* v. *Westchester Service Corp.*, 293 U. S. 449, which applied the Act to an interstate contract in a diversity case, might be decided differently under the *Bernhardt* holding that arbitration is outcome determinative, 350 U. S., at 202.

[17] For an anlysis of these alternatives, see generally, Symposium, Arbitration and the Courts, 58 Nw. L. Rev. 468 (1963); Note, 69 Yale L. J. 847 (1960).

contracts,[18] and to hold the Act inapplicable in diversity cases would be severely to limit its impact. As to the second alternative, it is clear that Congress in passing the Act relied primarily on its power to create general federal rules to govern federal courts. Over and over again the drafters of the Act assured Congress: "The statute establishes a procedure in Federal courts . . . . It rests upon the constitutional provision by which Congress is authorized to establish and control inferior Federal courts. So far as congressional acts relate to the procedure in Federal courts, they are clearly within the congressional power."[19] And again: "The primary purpose of the statute is to make enforceable in Federal courts such agreements for arbitration, and for this purpose Congress rests solely upon its power to prescribe

[18] The House Report accompanying the Act expressly stated: "The purpose of this bill is to make valid and enforceable agreements for arbitration contained in contracts involving interstate commerce . . . *or which may be the subject of litigation in the Federal courts.*" H. R. Rep. No. 96, 69th Cong., 1st Sess., 1 (1924) (emphasis added). Mr. Cohen, commenting on the Act after its passage, explained: "The Federal courts are given jurisdiction to enforce such agreements whenever under the Judicial Code they would have had jurisdiction . . . . Where the basis of jurisdiction is diversity of citizenship, the dispute must involve $3000 as in suits at law." Cohen & Dayton, *supra*, at 267. See, *e. g.*, Committee on Commerce, Trade & Commercial Law, The United States Arbitration Law and Its Application, 11 A. B. A. J. 153, 156; Note, 20 Ill. L. Rev. 111 (1925). The bill, as originally drafted by the American Bar Association, 49 A. B. A. Rep. 51–52 (1924), and introduced in the House, H. R. No. 646, 68th Cong., 1st Sess. (1924), 65 Cong. Rec. 11081–11082 (1924), expressly provided in § 8 "[t]hat if the basis of jurisdiction be diversity of citizenship . . . the district court . . . shall have jurisdiction . . . hereunder notwithstanding the amount in controversy is unascertained . . . ." Though that provision was deleted by the Senate, the omission was not intended substantially to alter the law. 66 Cong. Rec. 3004 (1925).

[19] Committee on Commerce, *supra*, 11 A. B. A. J., at 154.

the jurisdiction and duties of the Federal courts."[20] One cannot read the legislative history without concluding that this power, and not Congress' power to legislate in the area of commerce, was the "principal basis" of the Act.[21] Also opposed to the view that Congress intended to create substantive law to govern commerce and maritime transactions are the frequent statements in the legislative history that the Act was not intended to be "the source of . . . substantive law."[22] As Congressman Graham explained the Act to the House:

> "It does not involve any new principle of law except to provide a simple method . . . in order to give enforcement . . . . *It creates no new legislation, grants no new rights, except a remedy* to en-

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[20] Senate Hearings, *supra*, at 38.

[21] Although Mr. Cohen, in a brief filed with Congress, suggested that Congress might rely on its power over commerce, he added that there were "questions which apparently can be raised in this connection," *id.*, at 38, and expressly denied that "the proposed law depends for its validity upon the exercise of the interstate-commerce and admiralty powers of Congress," *id.*, at 37. And when he testified, he made the point clearer:

"So what we have done . . . [in New York] is that we have . . . made it a part of our judicial machinery. That is what we have done. But it can not be done under our constitutional form of government and cover the great fields of commerce until you gentlemen do it, in the exercise of your power to confer jurisdiction of the Federal courts. The theory on which you do this is that you have a right to tell the Federal courts how to proceed." *Id.*, at 17.

The legislative history which the Court recites to support its assertion that Congress relied principally on its power over commerce consists mainly of statements that the Act was designed to cover only contracts in commerce, and that is certainly true. But merely because the Act was designed to enforce arbitration agreements only in contracts in commerce, does not mean that Congress was primarily relying on its power over commerce in supplying that remedy of enforceability.

[22] Cohen & Dayton, *supra*, at 276.

> force an agreement in commercial contracts and in admiralty contracts." 65 Cong. Rec. 1931 (1924). (Emphasis added.)

Finally, there are clear indications in the legislative history that the Act was not intended to make arbitration agreements enforceable in state courts[23] or to provide an independent federal-question basis for jurisdiction in federal courts apart from diversity jurisdiction.[24] The absence of both of these effects—which normally follow from legislation of federal substantive law—seems to militate against the view that Congress was creating a body of federal substantive law.

Suffice it to say that Judge Medina chose the alternative of construing the Act to create federal substantive law in order to avoid its emasculation under *Erie* and *Bernhardt*. But Judge Medina was not content in stopping there with a holding that the Act makes arbitration agreements in a contract involving commerce

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[23] See, *e. g.*, Cohen & Dayton, *supra*, at 277; Committee on Commerce, *supra*, at 155, 156. Mr. Bernheimer suggested that the Act might have the beneficial effect of encouraging States to enact similar laws, Joint Hearings, *supra*, at 28, but Mr. Cohen assured Congress:

"Nor can it be said that the Congress of the United States, directing its own courts . . . , would infringe upon the provinces or prerogatives of the States. . . . [T]he question of the enforcement relates to the law of remedies and not to substantive law. The rule must be changed for the jurisdiction in which the agreement is sought to be enforced . . . . There is no disposition therefore by means of the Federal bludgeon to force an individual State into an unwilling submission to arbitration enforcement." *Id.*, at 39–40.

[24] This seems implicit in § 3's provision for a stay by a "court in which such suit is pending" and § 4's provision that enforcement may be ordered by "any Court of the United States which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties."

enforceable in federal court even though the basis of jurisdiction is diversity and state law does not enforce such agreements. The problem in *Lawrence*, as here, was not whether an arbitration agreement is enforceable, for the New York Arbitration Act, upon which the Federal Act was based, enforces an arbitration clause in the same terms as the Federal Act. The problem in *Lawrence*, and here, was rather whether the arbitration clause in a contract induced by fraud is "separable." Under New York law, it was not: general allegations of fraud in the inducement would, as a matter of state law, put in issue the making of the arbitration clause. So to avoid this application of state law, Judge Medina went further than holding that the Federal Act makes agreements to arbitrate enforceable: he held that the Act creates a "body of law" that "encompasses questions of interpretation and construction as well as questions of validity, revocability and enforceability of arbitration agreements affecting interstate commerce or maritime affairs." 271 F. 2d, at 409.

Thus, 35 years after the passage of the Arbitration Act, the Second Circuit completely rewrote it. Under its new formulation, § 2 now makes arbitration agreements enforceable "save on such grounds as exist at *federal* law for the revocation of any contract." And under § 4, before enforcing an arbitration agreement, the district court must be satisfied that "the making of the agreement for arbitration, *as a matter of federal law*, is not in issue." And then when Judge Medina turned to the task of "the formulation of the principles of federal substantive law necessary for this purpose," 271 F. 2d, at 409, he formulated the separability rule which the Court today adopts—not because § 4 provided this rule as an "explicit answer," not because he looked to the intention of the parties, but because of his notion

that the separability rule would further a "liberal policy of promoting arbitration." 271 F. 2d, at 410.[25]

Today, without expressly saying so, the Court does precisely what Judge Medina did in *Lawrence*. It is not content to hold that the Act does all it was intended to do: make arbitration agreements enforceable in federal courts if they are valid and legally existent under state law. The Court holds that the Act gives federal courts the right to fashion federal law, inconsistent with state law, to determine whether an arbitration agreement was made and what it means. Even if Congress intended to create substantive rights by passage of the Act, I am wholly convinced that it did not intend to create such a sweeping body of federal substantive law completely to take away from the States their power to interpret contracts made by their own citizens in their own territory.

First. The legislative history is clear that Congress intended no such thing. Congress assumed that arbitration agreements were recognized as valid by state and federal law.[26] Courts would give damages for their breach, but simply refused to specifically enforce them. Congress thus had one limited purpose in mind: to provide a party to such an agreement "a remedy formerly denied him."[27] "Arbitration under the Federal . . . statute is simply a new procedural remedy."[28] The Act "creates no new legislation, grants no new rights, except

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[25] It should be noted that the New York courts apparently do not find any inconsistency between application of a nonseparability rule and that State's policy of enforcing arbitration agreements, a policy embodied a statute from which the Federal Act was copied.

[26] S. Rep. No. 536, 68th Cong., 1st Sess., 2 (1924); Joint Hearings, *supra*, at 38.

[27] Cohen & Dayton, *supra*, at 271.

[28] *Id.*, at 279.

a remedy to enforce . . . ." [29] The drafters of the Act were very explicit:

> "A Federal statute providing for the enforcement of arbitration agreements does relate solely to procedure of the Federal courts. *It is no infringement upon the right of each state to decide for itself what contracts shall or shall not exist under its laws.* To be sure *whether or not a contract exists is a question of the substantive law of the jurisdiction wherein the contract was made.*" Comm. on Commerce, *supra*, 11 A. B. A. J., at 154. (Emphasis added.)
>
> "Neither is it true that such a statute, declaring arbitration agreements to be valid, is the source of their existence as a matter of substantive law. . . . So far as the present law declares simply the policy of recognizing and enforcing arbitration agreements in Federal courts it does not encroach upon the province of the individual states." Cohen & Dayton, *supra*, at 276–277.

All this indicates that the § 4 inquiry of whether the making of the arbitration agreement is in issue is to be determined by reference to state law, not federal law formulated by judges for the purpose of promoting arbitration.

Second. The avowed purpose of the Act was to place arbitration agreements "upon the same footing as other contracts." [30] The separability rule which the Court applies to an arbitration clause does not result in equality between it and other clauses in the contract. I had always thought that a person, who attacks a contract on the ground of fraud and seeks to rescind it, has to seek rescission of the whole, not tidbits, and is not given the option of denying the existence of some clauses and

[29] 65 Cong. Rec. 1931 (1924).

[30] H. R. Rep. No. 96, 68th Cong., 1st Sess. (1924).

affirming the existence of others. Here F & C agreed both to perform consulting services for Prima and not to compete with Prima. Would any court hold that those two agreements were separable, even though Prima in agreeing to pay F & C not to compete did not directly rely on F & C's representations of being solvent? The simple fact is that Prima would not have agreed to the covenant not to compete or to the arbitration clause but for F & C's fraudulent promise that it would be financially able to perform consulting services. As this Court held in *United States* v. *Bethlehem Steel Corp.*, 315 U. S. 289, 298:

> "Whether a number of promises constitute one contract [and are non-separable] or more than one is to be determined by inquiring 'whether the parties assented to all the promises as a single whole, so that there would have been no bargain whatever, if any promise or set of promises were struck out.' "

Under this test, all of Prima's promises were part of one, inseparable contract.

Third. It is clear that had this identical contract dispute been litigated in New York courts under its arbitration act, Prima would not be required to present its claims of fraud to the arbitrator if the state rule of nonseparability applies. The Court here does not hold today, as did Judge Medina,[31] that the body of federal substantive law created by federal judges under the Arbitration Act is required to be applied by state courts. A holding to that effect—which the Court seems to leave up in the air—would flaunt the intention of the framers of the Act.[32] Yet under this Court's opinion today—that the Act supplies not only the remedy of enforcement but a body of federal doctrines to determine the validity

[31] "This is a declaration of national law equally applicable in state or federal courts." 271 F. 2d, at 407.

[32] See n. 23, *supra*.

of an arbitration agreement—failure to make the Act applicable in state courts would give rise to "forum shopping" and an unconstitutional discrimination that both *Erie* and *Bernhardt* were designed to eliminate. These problems are greatly reduced if the Act is limited, as it should be, to its proper scope: the mere enforcement in federal courts of valid arbitration agreements.

IV.

The Court's summary treatment of these issues has made it necessary for me to express my views at length. The plain purpose of the Act as written by Congress was this and no more: Congress wanted federal courts to enforce contracts to arbitrate and plainly said so in the Act. But Congress also plainly said that whether a contract containing an arbitration clause can be rescinded on the ground of fraud is to be decided by the courts and not by the arbitrators. Prima here challenged in the courts the validity of its alleged contract with F & C as a whole, not in fragments. If there has never been any valid contract, then there is not now and never has been anything to arbitrate. If Prima's allegations are true, the sum total of what the Court does here is to force Prima to arbitrate a contract which is void and unenforceable before arbitrators who are given the power to make final legal determinations of their own jurisdiction, not even subject to effective review by the highest court in the land. That is not what Congress said Prima must do. It seems to be what the Court thinks would promote the policy of arbitration. I am completely unable to agree to this new version of the Arbitration Act, a version which its own creator in *Robert Lawrence* practically admitted was judicial legislation. Congress might possibly have enacted such a version into law had it been able to foresee subsequent legal events, but I do not think this Court should do so.

I would reverse this case.